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RISK RETENTION AMENDMENTS OF 1986

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HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSUMER

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 2129

TO FACILITATE THE ABILITY OF ORGANIZATIONS TO ESTABLISH RISK RETENTION GROUPS, TO FACILITATE THE ABILITY OF SUCH ORGANIZATIONS TO PURCHASE LIABILITY INSURANCE ON A GROUP BASIS, AND FOR OTHER PURPOSES

MARCH 20, 1986

Printed for the use of the
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RISK RETENTION AMENDMENTS OF 1986

THURSDAY, MARCH 20, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON THE CONSUMER,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1:20 p.m., in Room SR-232A, Russell Senate Office Building, Hon. Bob Kasten (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: David Zorensky, staff counsel and Amy Bondurant, minority staff counsel.

OPENING STATEMENT BY SENATOR KASTEN

Senator KASTEN. Today the Consumer Subcommittee is holding a hearing on S. 2129, the Risk Retention Amendments of 1986.

This bill would amend the Product Liability Risk Retention Act to make it easier for small businesses, associations, professional groups, municipalities, schools, and other organizations to form collective purchasing groups and self-insurance or "risk retention" groups for general liability coverage.

In 1981, I was one of the original cosponsors of the Product Liability Risk Retention Act. That measure was enacted at a time when the insurance market had stabilized and the availability of insurance was not as much a concern as subjective ratemaking linked to the unpredictability of our product liability litigation system. That problem remains. But today matters are much worse, because we face a crisis with respect to the increasing cost and scarcity of liability insurance for everyone.

This is a matter of national concern that has been well documented before this committee. Today, small businesses, municipal governments, resort operators, day-care providers, schools, truckers, hazardous waste disposers, corporate directors, and officers, nurse-midwives, physicians, architects, and other professionals find themselves facing huge premium increases for liability insurance. Some have had their coverage cancelled or have faced reduced coverage with increased deductibles. Others cannot obtain coverage at any price.

The legislation we are considering at this hearing today is a response to this problem. However, as an original cosponsor of S. 2129, I must note that this proposed expansion of the Risk Retention Act is not a cure-all for the liability insurance problem. It would only facilitate the ability of those seeking general liability coverage to obtain more favorable rates and to self-insure as part of a risk retention group. It does so by preempting—to the extent necessary—conflicting State laws and regulations that restrict the purchase of general liability insurance on a group basis and impede the operation of multi-State risk retention groups.

Although it is not a cure-all for the problem, expansion of the Risk Retention Act should provide some relief for those affected by the current liability insurance crisis; it should make it easier for those without coverage to help themselves and promote competition that will enable those seeking liability coverage to do so at more affordable rates.

There are those of us who approach the liability insurance crisis with different views of its causes. I am among those who think that ultimately the insurance market cannot be stabilized until we address the underlying problem of reform of our civil justice system. But I also think there is general agreement that the immediate relief provided by S. 2129 is appropriate to give those seeking affordable liability insurance coverage a greater opportunity to help themselves.

It is my hope that after this hearing we will be able to move ahead expeditiously to give them such an opportunity.

Senator Gore, do you have any comments at this time before we begin with our witnesses?

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Mr. Chairman, I have a brief statement.

First of all, I would like to thank you and the staff of the Committee and the witnesses for your efforts to have this hearing on such short notice. As a co-sponsor of S. 2129, I am extremely concerned that we pass this measure as soon as possible.

Otherwise, many of the groups that it is intended to benefit may have to close their doors for lack of liability insurance.

Further, it is important that we avoid efforts to drastically alter the ability of this legislation to provide meaningful alternatives to unavailable commercial insurance.

At the same time I am fully aware that few, if any, bills are ever perfect on introduction and I am eager to hear the suggestions for changes in this legislation which could provide additional safeguards to consumers of the group plans and the general public.

Use of mechanisms that exist under current State laws or new mechanisms that could be created under Federal law to ensure sound financial conditions among risk retention groups should be an important focus of today's hearing.

I look forward to the testimony today as an opportunity to explore what, if anything, needs to be done to make that a better bill. The ultimate goal should be to pass the best legislation we can get in this Committee to ensure swift passage when it comes to the Floor of the Senate.

Thank you.

Senator KASTEN. Thank you, Senator.

Senator Rockefeller, do you have any comments at this time?

OPENING STATEMENT BY SENATOR ROCKEFELLER

Senator ROCKEFELLER. Mr. Chairman, I am not a member of the subcommittee. I am here because I care about the bill very much.

I just want to point out that at the last hearing we had I described a situation in Raleigh County, WV. This county had to more or less shut down until they were bailed out by a Turkish insurance firm—not being able to secure any other insurance.

Since then, McDowell County and other West Virginia counties have run into insurance problems. McDowell County had to shut down head start programs and job training programs because it was unable to get insurance.

I join with you and Senator Gore in urging that this bill should be passed as quickly as possible.

[The statement follows:]

OPENING STATEMENT BY SENATOR ROCKEFELLER

Mr. Chairman, as much as we want it to, the liability insurance crisis just won't go away. A few weeks ago, a county commissioner in my state told this distinguished panel about the insurance quandary his county was in until very recently. After weeks of being turned down by one American company after another, the county was finally forced to negotiate a contract with an insurance company headquartered in Turkey. The commissioner told us that he could only hope that "if and when a claim occurs, they will be there to respond."

It's time Congress began responding to this crisis. The situation shows no sign of improvement and, in fact, seems to be getting worse.

Since that hearing, McDowell County—the poorest part of my state—lost its Head Start and job training programs for two weeks recently while it frantically searched for adequate insurance. A fledgling business in the eastern part of my state can't even get off the ground because of insurance problems. And there are 250 potential jobs at stake in a state that desperately needs them.

To add to the dismal insurance situation in my state, last week the West Virginia State Legislature adjourned for the year. Insurance—particularly municipal insurance—was at the top of the Legistature's agenda. The Legislature, however, closed its doors without enacting significant insurance reform legislation. My state's Municipal League has called for a special legislative session to address the insurance crisis—but who knows what the likelihood of that is.

For all of us here today, the message should be loud and clear. I know that this hearing was called to address the concerns that several of my colleagues expressed at the last business meeting. I agree, however, with the county commissioner who testified before us last month: we have an obligation to try to harness this "runaway monster *now*." The Risk Retention Amendments of 1986 may not be the ultimate remedy—but it can provide temporary relief.

We have an obligation to move quickly on this measure. To our towns and counties, to small businesses, to day care providers and others, time is clearly of the essence. The Product Liability Risk Retention Act was first introduced in 1979. It was not until 1981 that this bill was signed into law and by that date the insurance crunch of the time had passed. This time, we have been told, that the insurance crisis is far deeper and more widespread. If passage of S. 2129 takes too long, it may spell the end for some organizations and businesses. I know that our nation's towns and cities will lose talented public servants who will choose not to serve uninsured.

Mr. Chairman, I strongly urge this committee to pass this bill before the Easter recess.

Senator KASTEN. Thank you.

I would like to thank both of you for being here. Obviously, this is an issue that involves a number of us, not just members of the Consumer Subcommittee. So, I welcome your particiption.

Before we begin with the first panel of witnesses, I would like to introduce into the record two different letters stating their support of this legislation.

One from the American Business Association and the other from the United States Conference of Mayors.

I also have received opening statements from Senator Pressler and Hollings which will be included in the record along with the bill, S. 2129.

[The statements and bill follow:]

Opening Statement by Senator Pressler

Today's hearing represents a new phase in our efforts to develop solutions to the current liability insurance crisis. This bill is the first of what I expect will be many initiatives to alleviate the causes and effects of the high cost and scarcity of insurance.

Expanding the Risk Retention Act will give businesses, governments, and professionals who are struggling to find adequate and affordable coverage the opportunity to group together to make sure they are properly insured. It is important that we move ahead with this bill and other efforts to solve this problem.

We must keep in mind, however, that this bill is not a cure-all. A number of difficult insurance problems still need to be addressed. One of those problems is the rising cost of product liability insurance. Toward that end, I have introduced an amendment to the Product Liability Act to reform the doctrine of joint and several liability. The amendment would hold defendants severally liable for their acts, but only their acts—not those of other defendants. That step would help control the spiraling cost of product liability insurance. In addition, I intend to offer legislation to reform on a much broader scale the present application of the joint and several liability doctrine.

While it is important that we move forward today, we must do so carefully. Expanding the scope of the Risk Retention Act is a much-needed step in alleviating the insurance crunch. But we must also be sure that this step is taken in the proper manner. Several groups are concerned about various aspects of this legislation. I do not foresee any insurmountable problems with this bill, but we need to carefully consider this important piece of legislation. However, I do hope we can move this bill before the Easter recess.

I thank the distinguished chairman for holding this hearing on such short notice, and I look forward to hearing the comments and suggestions of the various witnesses.

Statement by Senator Hollings

I am an original cosponsor of S. 2129, the Risk Retention Act Amendments of 1986 and fully endorse the intent of the Act, which would make it easier for businesses, professional groups, local governments entities, and other buyers of insurance to purchase commercial liability coverage in this time of crisis.

The recent hearings that we have held in the Senate Commerce Committee on the availability and affordability problems faced by insurance buyers have convinced me that many entities are indeed facing a crisis. I certainly agree with the written testimony of the National Association of Insurance Brokers that the conventional marketplace is not functioning as well as it normally does. S. 2129 will create a safety valve for those who face the prospect of having to continue operations with no insurance at all.

I am also sympathetic with the problems of groups such as the certified nurse-midwives, who need expeditious enactment as they face the bleak prospect of "going bare" by mid-summer. The written testimony of the Risk and Insurance Management Society states that the expeditious enactment of the bill is particularly crucial in these times of crisis. The Society believes that S. 2129 would be used by many of its members and other policyholders to establish risk retention groups.

However, I am pleased that the Committee decided to delay briefly the consideration of this legislation in order to hold this hearing. I am certainly interested in all of the testimony such as that of the insurance agents, the state commissioners, and the companies; and I am certainly willing to consider proposals to further refine S. 2129. It is my hope that the Committee will move forward quickly to mark-up S. 2129 after considering the issues to be presented by the testimony today.

99TH CONGRESS
2D SESSION

S. 2129

To facilitate the ability of organizations to establish risk retention groups, to facilitate the ability of such organizations to purchase liability insurance on a group basis, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28 (legislative day, FEBRUARY 24), 1986

Mr. KASTEN (for himself, Mr. DANFORTH, Mr. HOLLINGS, and Mr. ROCKEFELLER) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

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A BILL

To facilitate the ability of organizations to establish risk retention groups, to facilitate the ability of such organizations to purchase liability insurance on a group basis, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Risk Retention Amendments of 1986".

SEC. 2. Section 1 of the Product Liability Risk Retention Act of 1981 (hereinafter referred to as "the Act") (15 U.S.C. 3901, note) is amended—

(1) by striking "Product"; and

(2) by striking "1981" and inserting in lieu thereof "1986".

SEC. 3. (a) Section 2(a) of the Act (15 U.S.C. 3901(a)) is amended—

(1) by striking paragraphs (1) and (3);

(2) by redesignating paragraph (2) as paragraph (1), and by redesignating paragraphs (4) through (6) as paragraphs (5) through (7), respectively;

(3) by inserting after paragraph (1), as so redesignated, the following:

"(2) 'liability insurance' means insurance covering an organization's legal liability for damages because of injuries to other persons, damage to their property, or other loss or damage arising out of its business, trade, products, services (including professional services), premises, or operations, but does not include (A) personal risk insurance or (B) workers' compensation and employers' liability insurance;

"(3) 'organization' means any association, business, corporation (whether forprofit or notforprofit), professional corporation or partnership, church, hospital, school, university, or other institution, or a State or local government (or agency of such a government);

"(4) 'personal risk insurance' means homeowners, tenant, private passenger nonfleet automobile, mobile

home, and other liability and casualty insurance primarily for personal, family or household needs rather than for business or professional needs;".

(4) in paragraph (5), as so redesignated—

(A) by striking ", State, Bermuda, or the Cayman Islands";

(B) in subparagraph (A), by striking "product liability or completed operations";

(C) in subparagraph (C), by striking all after "State" the first time it appears and inserting in lieu thereof "; and";

(D) in subparagraph (D), by striking "and"; and

(E) by striking subparagraph (E); and

(5) in paragraph (6), as so redesignated, by striking "product liability or completed operations".

(b) Section 2(b) of the Act (15 U.S.C. 3901(b)) is amended—

(1) by striking "product liability and product"; and

(2) by inserting "and personal risk insurance" immediately after "insurance" the second time it appears.

(c) Section 2 of the Act (15 U.S.C. 3901) is further amended by adding at the end thereof the following:

"(c) Nothing in this Act shall be construed to exempt a group authorized under this Act from the policy form or coverage requirements of any State no-fault automobile insurance.

"(d) The authority to offer or provide insurance under this Act is limited to liability insurance. This Act does not authorize a risk retention group or a purchasing group to provide coverage of any other line of insurance.".

SEC. 4. Subsection (a)(1)(C) and (D) and subsection (b)(1) and (2) of section 3 of the Act (15 U.S.C. 3902(a)(1)(C) and (D) and (b)(1) and (2), respectively) are amended by striking "product liability or completed operations".

SEC. 5. Section 4(b) of the Act (15 U.S.C. 3903(b)) is amended—

(1) in paragraph (1), by striking "product liability or completed operations liability insurance, and comprehensive general" and "which includes either of these coverages,"; and

(2) in paragraph (2), by striking "product liability or completed operations insurance, and comprehensive general".

Senator KASTEN. Now if we can have our first panel which is Mr. Connolly, Mr. Shaffer, Mr. Lynn and Mr. Cheek, come forward.

We will begin with Mr. Connolly, but before we begin, let me just explain that each witness is asked to summarize their remarks in 5 minutes or less. The entire testimony will be part of the record as if read.

We are also going to try to limit Senators to 5 minutes of questions back and forth so that we can go through the entire list of panelists and hopefully have opportunities for questions and responses to the maximum degree possible.

Our first witness is Mr. Dennis Connolly, vice president of the American Insurance Association, New York, NY.

Mr. Connolly.

STATEMENTS OF DENNIS CONNOLLY, VICE PRESIDENT, AMERICAN INSURANCE ASSOCIATION; GEORGE R. SHAFFER, PRESIDENT, INSURANCE CENTER, INC., REPRESENTING THE INDEPENDENT INSURANCE AGENTS OF AMERICA, THE PROFESSIONAL INSURANCE AGENTS, AND THE NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS; RICHARD E. LYNN, SENIOR VICE PRESIDENT, ALEXANDER AND ALEXANDER SERVICES, INC., REPRESENTING THE NATIONAL ASSOCIATION OF INDEPENDENT BROKERS; LESLIE CHEEK, VICE PRESIDENT, FEDERAL AFFAIRS, CRUM AND FORSTER INSURANCE COMPANIES

Mr. CONNOLLY. Thank you for having me here, Senator.

I am vice president for Liability for the American Insurance Association, but today I speak on behalf of our Association and the Alliance of American Insurers. Our member companies, 350 of them, provide coverage for the types of liabilities about which you are so concerned.

S. 2129 is too broad in its application. It expands the Risk Retention Act to almost all commercial lines of insurance, including not only those where policies are currently available, but extending to lines where insurance can be found easily.

We harbor no concerns about new companies coming into our already intensely competitive market. We do, however, have serious concerns about companies entering the insurance marketplace which are not subject to regulations which are designed to protect the public as well as those who may be insured.

The practical effect of the legislation is that these companies will be operating at a competitive advantage while their customers are deprived of the protections that State regulations currently afford consumers against unfair trade practices and potential insurer insolvency.

These protections are for the benefit of those being insured and also those who may need compensation from insurance. The committee should remain mindful that the two major components of regulation are to provide protection to consumers against unfair practices and to ensure that insurance is provided by financially solvent companies, capable of paying out future claims.

While always exercising these responsibilities, State regulators in recent years have taken a more active stand in promoting these two objectives. Adequately applied, solvency standards and insurer supported guarantee funds have assured that no major consumers of insurance or

injured parties have gone unprotected because of a failure of an insurance company.

Yet while the Associations would not oppose Congressional efforts to expand the Risk Retention Act to allow for grouping of lines where insurance is not available, we question the wisdom of legislation which permits the abrogation of State laws designed for consumer protection where insurance is already being provided.

The risks of this approach are greater and far outweigh the benefits being sought. We would, therefore, ask that Congress amend the legislation to mandate that a group established under this act can only do business where it is first demonstrated that the coverage it seeks to provide cannot be obtained from other insurers that are already operating within the State's boundaries.

These companies should at a minimum also be required to meet the financial operating standards that currently govern the carriers in those states. Among other things, this would include meeting minimum capital and surplus requirements that exist under the State laws.

The adoption of this provision, we feel, would help protect consumers. The Association recognizes the compelling need to go forward for several of the most distressed lines of business. For that reason, in critical lines where we are not currently providing coverage, we would recommend that companies established under this legislation be exempted from the demonstrated needs test. These would include nurse-midwives, asbestos removal contractors, environmental cleanup and environmental liability.

We also believe that consumers would be better protected were they to be made aware of the fact that insurance companies that are established under this act are not subject to the same standards and regulations for solvency as are admitted carriers. This information is vital for consumers to make an informed choice.

Were the committee to adopt our regulations, we would not oppose this bill. Yet it is important for the committee to recognize that this does not necessarily mean that we feel the problems facing the business community because of liability exposure will go away.

I think, Senator Kasten, you know that the difficulties arising from the liability system, the tort system, which makes it so impossible for us to predict liabilities, has the same effect upon those who would seek to self-insure.

In our testimony in 1981 on the Risk Retention Act, I was the person who presented the Associations' position of non-opposition to the 1981 act. That testimony, which is in the record, substantiated our efforts, working with Senate staff at that time and with the major business community, to develop a bill which we would not have to oppose and which we thought could meet the needs of consumers.

I would call to your attention, if you can find the record in April 1981, the fact that there was only one person who said that the Risk Retention Act for product liability would not be used because it was not a workable solution and it did not answer the tort problems. I can claim credit for being that one person.

I would ask you to look at my testimony again.
Thank you.
[The statement follows:]

STATEMENT OF AMERICAN INSURANCE ASSOCIATION

The American Insurance Association and the Alliance of American Insurers (Associations) are trade associations which represents approximately 350 property and casualty insurance companies. The member companies of the Associations provide the majority of the liability insurance coverage written throughout the United States. We have been asked to present testimony associated with this Committee's consideration of S. 2129, the Risk Retention Act Amendments of 1986. As stated by Chairman Danforth, "this legislation would provide an alternative to the commercial insurance market." Our Associations have testified to the Committee in previous hearings that our members cannot meet the needs for liability coverage in certain select lines of business and can appreciate the pressures that exists for the passage of this bill. We are grateful for the Committee's fair consideration of this legislation and thank you for giving us the opportunity to testify today.

INDUSTRY'S CONCERNS OVER THE SCOPE OF S. 2129

In its current form S. 2129 is too broad. It expands the Risk Retention Act to almost all commercial lines of business including not only those where policies are currently unavailable but extending to lines of business where primary and surplus insurers are already providing a market. Our critics will assert that we are seeking to limit competition. To this we respond that we harbor no concerns about new companies coming into our already intensely competitive industry. We do, however, have serious concerns about companies entering the insurance marketplace which are not subject to the same stringent regulations that are designed to protect the consuming public as are we. The practical effect of the legislation is that these companies will be operating at a competitive operating advantage while their customers are deprived of the protections that state regulation currently affords consumers against unfair trade practices or potential insurer insolvency. These protection are for the benefits of the insured but also benefit injured persons whose injuries require compensation.

The Committee should remain mindful that the two major components of regulation are to provide protection to consumers against unfair practices and rates while at the same time ensuring that the company with which a consumer is doing business is financially solvent and capable of paying out any future claims. While always exercising these responsibilities, state regulators in recent years have taken a more active stand in promoting these two objectives. There have, indeed, been times when some in our industry have differed with the Insurance Commissioners yet few can argue with the results. Adequately applied solvency standards and an insurer contributed guarantee fund have left none of our customers unprotected nor required the expenditure of taxpayers' money. Yet, while the Associations would not oppose Congressional efforts to expand the Risk Retention Act to allow for the writing of lines where insurance is not available, we question the wisdom of legislation which permits the abrogation of state laws designed for consumer protection where insurance is already being provided. The risks of this approach are great and far outweigh the benefits that are being sought.

We would therefore ask that Congress amend the legislation to mandate that a company established under this Act can only do business where it has first demonstrated that the coverage that it seeks to provide cannot be obtained by other insurers that are already operating within that state's borders.

These companies should at minimum be also required to meet the financial operating standards that currently govern carriers in their states. Among other things this would include meeting the minimum capital and surplus requirements that exist under the State's laws or regulations. The adoption of this provision will help protect consumers from insurer insolvency, unfair pricing, rate discrimination and misleading contract forms that are likely to exist in an unprotected marketplace.

The Associations recognize the compelling need to go forward for several of the most distressed lines of business. For that reason, in critical lines where we are currently not providing coverage, we would recommend that companies established under this legislation be exempt from the demonstrated needs test. This would include nurse-midwives, asbestos removal, environmental cleanup and environmental liability.

We also believe that consumers would be better protected were they to be made aware of the fact that insurance companies established under this Act are not subject to the same standards for solvency as are admitted carriers. This information is vital in order to make an informed choice and must be considered a salient factor for any individual or company that seeks to transfer its liability risks to its insurer.

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The Associations have worked closely with this Committee on other important legislative matters and indeed cooperated fully with its efforts in the passage of S. 69, the 1981 Risk Retention Act. We intend to continue our pattern of constructive dialogue and feel that the testimony which we offer today fosters that purpose. Our industry has a clear interest in making certain this legislation works to accomplish the dual goals of the regulated marketplace. Unlike most other products sold on the market, a consumer does not derive pleasure from our product itself, but from the peace of mind that an insurance contract brings. To the extent that lax regulation for companies established under the Risk Retention Act undermines confidence in our product, the purchaser of that contract not only suffers but so do all others who pay for our product as well.

Were the Committee to adopt our recommendations, several of our member companies have indicated that they will support the legislation. Yet it is important for the Committee to recognize that this does not necessarily mean they feel that the problems facing the business community because of liability exposure will go away. Assuming proper management, those companies which choose to have their risks insured by a company that is established under the expanded Act will still find that their liability exposure remains subject to the uncertainty of the evolving civil justice system. Their experience will probably reflect ours, as did the Medical Mutual Malpractice Companies established a decade ago. Speaking before this Committee two weeks ago, Dr. James Todd of the American Medical Association told you that the Medical Mutuals did indeed enjoy significant apparent profits during their first years of operations. The results changed dramatically once claims started to be filed and the rate increases of Medical Mutuals like ours have gone up dramatically to reflect trends in the civil justice reform that have expanded physician's exposure. We therefore hope the adoption of this legislation will not divert efforts taking place on the state level for comprehensive reform of the civil justice system.

In concluding, the Associations believe that the imposition of minimum consumer protection safeguards are clearly in the public interest and could very well spare this Committee from complaints which might arise two or three years from now from consumers who entrust their financial future with an unregulated carrier.

We would again thank you for providing us with the opportunity to testify and want to assure you that we intend to work closely with you in improving this legislation as the process goes ahead.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. We have heard some concern expressed that this legislation would allow anyone to form a risk retention group regardless of the severity of their insurance problems.

If we can establish reasonable criteria which individuals must meet before they can form such a group, without defeating the purpose of the bill, why shouldn't we allow these groups to compete with the established industry?

Answer. The insurance industry has suggested that the Risk Retention Act may be used in a reasonable circumstance if certain change are made to that legislation. First is that since the legislation avoids a substantial body of regulation to which the insurance industry as a whole is subjected and which is intended to protect both insureds and persons injured by those insureds, those protections should not be lightly discarded. The industry therefore has suggested that where an exemption from those regulations is offered, it should be done on the basis of special need; a demonstration that insurance is not otherwise available. Secondly, the industry has noted that while some regulations may be viewed as impediments to the formation of insurance companies and sales activities in other states by those groups, many of those regulations are intended to protect the citizenry of the states. We suggest therefore that in addition to some demonstration that there needs to be a waiver of state regulation that those groups which are formed should be subject to those regulations which are intended to protect the citizenry of the states. A careful screening of those types of regulations can be made and incorporated into the Risk Retention Act without impeding the reasonable formation of risk retention groups.

We would be happy to work with anyone in the Senate on developing a list of those reasonable regulations in the State to which risk retention groups should be subjected. It is important to note that state regulation for insurers is roughly the equivalent of safety regulation for airlines and that the type of deregulation which is proposed in the case of the Risk Retention Act is deregulation which would large-

ly effect safety rather than market structure. It's as though one were to deregulate the airlines by maintaining all of their market restrictions but deregulating safety requirements.

Question. Some groups have expressed concern about the potential risk of insolvency faced by the risk retention groups that would be formed under this bill. Others have persuasively pointed out that requiring state-by-state approval or, in effect, veto authority would really make this legislation too cumbersome to provide effective relief.

Would it make sense to establish some sort of national financial and other standards which perhaps might be enforced and monitored on the Federal level?

Answer. There are two answers to an insolvency of a risk retention group. One is of course to simply allow the members to discover only too late that they have been brought into an insurance mechanism without substance and that they and those that they may have injured are now no longer protected. An alternate response is either to make the membership of the risk retention group jointly liable for the liabilities assumed by the group itself, in which case all members would be subject to assessments to guarantee those limits which might be provided by their policies. This is done regularly in state formed reciprocal insurers. Another broader approach might be to establish a risk retention group guarantee fund to which all risk retention groups would contribute and which would then be available to respond to a failure by any such group. One or another of these approaches or a combination would substantially strengthen the risk retention group concept and would furthermore assure that the Federal Government has a reduced involvement in the event of an insolvency of any group for which its law is responsible.

Question. Has the insurance industry developed any estimates of the amount of insurance premium that would be diverted from the regular insurance market into the risk retention groups?

Answer. The insurance industry has not developed any estimate of the amount of insurance premiums that would be diverted from the regular market into the risk retention groups. There is some concern that was expressed at the passage of the Product Liability Risk Retention Act that a certain amount of adverse selection might occur and that the larger and secure insureds might tend to leave the regulated market for the risk retention group market thereby increasing the adverse selection in the regular market and exacerbating the availability problems that exist today by reducing the commercial insurance industry's capacity. This might be particularly true if through the avoidance of regulation, risk retention groups were able to function at reduced cost. These costs would be unavoidable in the regulated commercial market.

Question. Do you expect that this bill will increase competition in the insurance market and help bring down insurance prices?

Answer. Notwithstanding the various attacks upon the insurance industry, there has not been a suggestion of any serious merit that the insurance industry is anything but competitive. Similarly, both those who attack and those who support the insurance industry have suggested that price decreases in the insurance industry were inappropriate and the function of the risk retention proposal is not to increase competition in an already competitive industry but rather to allow the formation of groups where that competitive industry cannot function. If the risk retention act were to bring down prices, then it is very likely that the result would be increased insolvencies of the very sort about which insurers are concerned.

Question. Since the Commerce Committee is exploring a variety of solutions to the overall insurance problem, I would like to ask a question indirectly related to the issue at hand.

Do you feel that my joint and several liability amendment in product liability cases would alleviate the difficulty businesses have in finding adequate and affordable product liability insurance?

Do you feel it would be appropriate to extend this concept to other areas, such as environmental issues, and would such a move have any effect on the price and availability of other types of liability insurance?

Answer. The American Insurance Association has taken the position that joint and several liability as it is currently used by State courts does not permit individual risk assessment of insureds. The insurer facing an already difficult climate in ascertaining the risk potential of its insured in a near no-fault strict liability climate finds that problem is increased substantially by the doctrine of joint liability. The insurer must not only assess the risk of its particular potential insured, but the risk of any other entity with which the potential insured may interact. This doctrine is extremely troublesome from an underwriter's point of view and makes the prediction of risk extremely difficult.

The American Insurance Association applauds Senator Pressler's proposal to reject the doctrine of joint liability and suggests that it will have an overall beneficial and substantial effect on the availability and more accurate pricing of product liability insurance. We feel furthermore, that the doctrine of several liability should be extended to numerous other liability areas. Joint liability is for example, a major problem for municipalities, whose acts bring them regularly into contact with hundreds of unknown other entities. In addition, the American Insurance Association has testified on numerous occasions that it is the belief of the American Insurance Association that the doctrine of joint liability is a major impedient to the settlement of environmental claims and to the ability of insurers to provide coverage for that type of liability.

Senator KASTEN. Mr. Connolly, we thank you.

Next is Mr. George Shaffer, president of the Insurance Center, representing the Independent Insurance Agents of America, Professional Insurance Agents, and the National Association of Casualty and Surety Agents.

Mr. Shaffer.

Mr. SHAFFER. Thank you, Mr. Chairman.

I am further representing here this morning the National Association of Service Lines Agents, Professional Surplus Lines Offices (NAPSLO). These four associations repesent the bulk of the independent insurance agents and surplus line brokers in America.

Mr. Chairman, as presently drafted the Risk Retention Amendments of 1986 are neither practical nor responsible as an insurance alternative for buyers or claimants. There is no one more aware of or more frustrated by the current availability/affordability crisis than the property casualty insurance agent.

We know that members of Congress have of late been confronted head on by the serious and widespread plight of their constituents who inform you that the liability insurance well has run dry or that insurance is unavailable because it has become unaffordable. We know this, Mr.\Chairman, because your constituents are our clients.

I cannot stress that enough. It is our professional responsibility as insurance agents to obtain proper and affordable insurance coverage for each and every one of these adversely affected buyers. It is the insurance agent who is the bearer of bad tidings in the marketplace, and we all know the fate of the messenger.

Specifically, can the Risk Retention Amendments of 1986, S. 2129, be considered part of this solution? The short answer is no, not as currently drafted. Even if perfected, S. 2129 would do little to solve the insurance woes of the vast majority of buyers.

However, the amendments could worsen the current situation and leave us all with bloody hands in the event that groups are found to be underfunded when called upon to perform in the event of a claim brought against a member of the risk retention group.

Mr. Chairman, look at the current statute. Is it not just a little bit ironic that, to my knowledge, no more than two or three risk retention or purchasing groups have come into existence?

That is most fortunate for if many more groups had in fact opted to form these risk retention groups, the current statute sanctions them to be undercapitalized, underreserved, ill managed and unregulated pools.

No less important, we would also be confronting a far more serious predicament for both buyers and potential claimants than we are today. Why?

Let us examine the facts. What is it that has prompted the need for this hearing and for the proposal before us? Although we may not all agree on the underlying causes of this predicament. There is no denying that hundreds of heavily capitalized, well managed and heavily regulated insurance companies have suffered billions of dollars in operating losses as a direct consequence of placing themselves at risk for the very types of liability exposures that would confront the potential participants in risk retention groups. Further the insurance industry has recently witnessed a number of dramatic insolvencies and the National Association of Insurance Commissioners has added hundreds of companies to their insolvency watch list. Why?

Insurance companies have been paying out billions of dollars more in claims than they have been receiving in premiums and even investment income. Many risk retention proponents are asserting that they are paying grossly excessive premiums in the market. Just where is the logic that risk retention groups formed expressly so their members could allocate less money for more protection would be better able to meet adverse claim experience than sophisticated insurers?

The short answer is that they could not. Unlike standard insurers, risk retention groups would not be protected by guarantee funds or adequately regulated since under present law they are virtually exempt from most regulation in the various States in which they will operate other than the State of domicile.

The Risk Retention Act provides illusory protection in a most irresponsible manner. Why are insurance agents interested in whether risk groups are well managed, adequately funded or well regulated? There are three good reasons:

First, risk retention groups, as envisioned by S. 2129, are equivalent to being commercial liability insurance companies except they will not be regulated as such;

Second, faced with no other available means of placing insurance coverage for a client, many insurance agents will either place business with risk retention groups or form groups themselves; and

Third, not the least important, should a risk retention group go insolvent and fail to pay claims, it is the insurance agent who could well be held professionally liable in Court. In addition, the insurance agent could be subject to legitimate disciplinary action by the State insurance department.

Having said all of the above, Mr. Chairman, it will come as no surprise that we have many reservations about the use of risk retention groups as envisioned by the drafters of S. 2129. However, we have narrowed our recommendations to this committee to four primary concerns.

Briefly, they are: First, financial condition. If the risk retention group is loosely regulated and fails to perform financially, S. 2129 will not only have failed the buyer who has invested in the group, but more importantly, the injured claimant;

Second, demonstrated need. Granted the insurance marketplace is troubled, but in all liability lines and the depth of the problem varies by State. We strongly believe the role of the Federal Government in this crisis should be only to provide relief where relief is needed, no more and no less. The rest is a State regulatory matter;

Third, fair trade practice.

And the fourth is definition of liability that we limit it to strictly third-party commercial liability.

This concludes our statement. We want to work with you on this proposal and are willing to sit down and discuss the specific amendment.

Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. We have heard some concern expressed that this legislation would allow anyone to form a risk retention group regardless of the severity of their insurance problems.

If we can establish reasonable criteria which individuals must meet before they can form such a group, without defeating the purpose of the bill, why shouldn't we allow these groups to compete with the established industry?

Answer. If Congress can establish reasonable criteria which risk retention groups must meet prior to forming, without defeating the purpose of the bill, then these groups should be allowed to compete within the established industry.

If Congress does not establish reasonable criteria for risk retention group formation, an unregulated, parallel insurance industry will result.

As insurance producers, we do not argue that there is a void in certain lines which can be filled by risk retention groups. The argument focuses on the fact that the present risk retention legislation would: (1) allow groups to operate without being subject to the same regulations imposed upon the traditional insurance industry, (2) allow groups to offer coverage in lines where there is already adequate, competitive coverage available, and (3) allow groups to market coverage without providing for adequate consumer protection/company solvency guidelines.

Question 2. Some groups have expressed concern about the potential risk of insolvency faced by the risk retention groups that would be formed under this bill. Others have persuasively pointed out that requiring state-by-state approval or, in effect, veto authority would really make this legislation too cumbersome to provide effective relief.

Would it make sense to establish some sort of national financial and other standards which perhaps might be enforced and monitored on the federal level?

Answer. We do not feel it would be in the best interest of the insurance buying public, nor in the interest of retaining a solvent, viable insurance industry if Congress were to establish "some sort of national financial and/or other standards for protection from potential risk retention insolvency" with enforcement and monitoring done on the federal level. Such federal regulation of insurance would seriously threaten the intent of McCarran-Ferguson, which permits insurance companies to conduct business under the same state regulations that are more than capable of establishing solvency guidelines and operational regulations for risk retention groups. (See NAIC package of amendments.)

The intent of requiring state-by-state approval of risk retention groups is not to provide commissioners with "veto authority," it is intended to ensure effective relief from the availability crisis without endangering the traditional insurance industry's participation in the remaining competitive marketplace.

Question 3. Has the insurance industry developed any estimates of the amount of insurance premium that would be diverted from the regular insurance market into the risk retention groups?

Answer. The insurance producer groups represented by George Shaffer do not have estimates of the amount of insurance premiums which would be lost to risk retention groups. The producer groups do conclude, however, that any parallel insurance industry would have a distinct economic advantage over the traditional insurance industry if they were permitted to operate without the burden of solvency and operational regulations.

As a general reference, with the growth of group self-insured programs in Workers Compensation (WC) industry figures from the National Committee on Compensation Insurance (NCCI) show self-insurance now accounts for over 25% of all WC written. That is a growth from 5–25% in less than two years.

Question 4. Do you expect that this bill will increase competition in the insurance market and help bring down insurance prices?

Answer. S. 2129, as now written, would create unfair competition within the insurance industry by allowing unregulated risk retention groups to form and undercut those prices set by traditional insurance companies necessitated by the unpredictable, and grossly unfair, nature of this nation's civil justice system.

S. 2129 would not only bring down insurance prices, it would succeed in bringing the competitive, rebounding insurance industry to it's knees.

Question 5. Since the Commerce Committee is exploring a variety of solutions to the overall insurance problem, I would like to ask a question indirectly related to the issue at hand.

Do you feel that my joint and several liability amendment in product liability cases would alleviate the difficulty businesses have in finding adequate and affordable product liability insurance?

Do you feel it would appropriate to extend this concept to other areas, such as environmental issues, and would such a move have any effect on the price and availability of other types of liability insurance?

Answer. The insurance industry supports the abolition or modification of the application of joint and several liability as a necessary component in alleviating the difficulty businesses have in finding adequate and affordable product liability insurance. There is no data to suggest that, by addressing joint and several liability, the product liability insurance marketplace will once again return. Extensive tort reform is necessary for the return of the commercial liability maketplace. Amending the application of joint and several would be an appropriate concept to extend to other areas of liability, such as environmental liability. Such a move, however, would need to be supplemental by several necessary reforms within the civil justice system.

Senator KASTEN. Our next witness on this panel is Richard Lynn, senior vice president of Alexander and Alexander Services, Inc., representing the National Association of Insurance Brokers.

Mr. Lynn.

Mr. LYNN. Thank you for the invitation to appear today.

I am here to represent the NAIB, the National Association of Insurance Brokers. I am an officer of Alexander & Alexander, and I have been a working broker and manager for 30 years. Alexander & Alexander is an NAIB member and is the second largest insurance brokerage firm in the United States and in the world.

Clients of NAIB members operate in every State of the United States and internationally. Some employ a single person, others employ thousands. They act in every category of industrial, commercial, professional, service and not-for-profit enterprise.

We work for them primarily as individual entities, but we also work with many of their industry, trade and professional associations. We place insurance for our clients with hundreds of insurance companies.

I mention all this to reinforce the fact that our company and the other members of the NAIB have an intimate understanding of the business of insurance from the point of view of virtually all parts of our society.

In his statement on February 19, representing NAIB and his own company, Alan Page told you that the broker's primary job is to act as intermediary between buyers and sellers of insurance. As brokers, we operate in a very competitive segment of a very competitive industry.

However, when there is no seller of insurance, or when insurance, because of its cost or other features, becomes an inefficient means of transferring the would-be buyers' risk of loss, then brokers respond to our client's need to protect assets by developing new insurance capacity, or by facilitating alternative methods for reducing to a manageable system the random effects of unpredictable loss.

It is my understanding that this hearing has been called to discuss a proposal to expand the Product Liability Risk Retention Act of 1981 to apply to liability risks in addition to product liability.

Because the proposal would facilitate alternative risk management options at a time when the conventional marketplace is not functioning as well as it normally does, the NAIB feels a responsibility to support the concept. NAIB's policy position was stated on March 6, 1986. A copy of it is attached to my statement.

My company, Alexander & Alexander, supports the NAIB position.

We also support the concept of reforming tort laws and related matters, if the reforms have the effect of:

Increasing the predictability of monetary compensation for injury.

Assigning liability in a sound relationship to negligence.

Expediting the injured party's satisfaction.

And respecting the contractual intent between insured and insurer.

We believe that the insurance industry would be able to perform its economic function more efficiently on behalf of the rest of the country if meaningful tort reform were to take place. Among other results, foreign reinsurers would be more willing once again to compete in our marketplace.

Meanwhile, we have a crisis in liability insurance. In the normal course of events, this will ease. But it has already been a year and a half. I believe that it will be longer than that again before the conventional marketplace returns to a normal condition reasonably acceptable to all parties.

We believe that most insurance companies are doing their best to allocate their resources fairly. However, in 1986, there just are not enough resources to go around. Most companies are avoiding types of enterprises, such as pharmaceutical companies, day care centers, professional services, and lines of coverage such as pollution, directors and officers, bus liability, and professional liability.

They are doing this because they believe the loss exposures are too volatile to price correctly—for whatever reason—or where they cannot get the price, or where they individually lack the underwriting, engineering and claims experience to act in a responsible way. Many insurers have been punished harshly over the past couple of years for providing coverage in these areas.

Mainly, there is a shortage of capacity and, in the case of foreign support for the U. S. market, a shortage of willing capacity.

Whatever the causes, American businesses, professionals, not-for-profit and municipal organizations are suffering. As they have told you, some are paying more for liability insurance than they can afford. This is not necessarily because the price of insurance is wrong. Rather it is because the overall competitive pricing mechanisms in their own industries have for many years assumed a lower level of insurance cost.

Some are doing without, or doing with much less than is available. They are gambling that no serious loss will occur, but a small loss is serious to a small company. Some companies simply cannot find an insurer. Others must insure whatever the cost, or go out of business, because their customers demand a certificate of insurance.

Many companies and organizations, it must be said, have been fortunate in continuing to find adequate insurance at affordable prices.

Today we are concerned with the many who are in trouble. The proposed expansion of the 1981 act appears to change nothing in the original act except the breadth of the kinds of liability risk which retention groups and purchasing groups can legally become involved with.

The facilitation provided by the 1981 act for forming and operating such groups appears to be unchanged. Both are eased by exemption from the application of some securities and insurance laws, rules and regulations.

Is the expansion to other lines justified by present circumstances?

In 1975 through at least 1977, during the last hard market, the main problem, aside from medical malpractice, was products liability. Other liability coverages and limits were difficult to handle, but by and large could be handled.

The issue was cost more than availability, although availability was severely constrained. Today, many more companies and industries are short of insurance. They are bare of some coverages altogether or believe they are paying much more than their risk justifies. From this viewpoint, expansion of the act is in order.

A risk retention group is not a novelty. While many existing insurance companies were founded by entrepreneurs as profit-making ventures, many were originally created by people who needed insurance and pooled their resources to create an insurer. Most of the latter were mutual companies or reciprocal exchanges..

However, the sharing or risk was the motivation even if they took the legal form of stock companies.

Senator KASTEN. Mr. Lynn, we are going to have to ask you to summarize the remainder of your statement.

Mr. LYNN. A purchasing group is not an insurer and must rely on negotiating with insurance companies. In all candor, no risk retention group will come into existence unless enough individual enterprises decide that their financial resources and financial security should be committed to it and they will make this commitment only if they believe a risk retention group is the best available risk management technique.

Mr. Chairman, it must be acknowledged that the threshold is high. Groups are not easy to form. Capital is hard to raise, conventional market prices are not necessarily high in relation to risk.

Agreement on what to do and how to do it is not easy to arrive at. A true risk retention group, soundly funded and administered will be created only when the potential members' pain is real and is widely felt.

The proposed expansion of the act creates options and does so without Federal capitalization or guarantees. Regulations for solvency is left in the hands of the States. The would-be buyers of liability insurance are offered a chance to improve their position if they are willing to commit resources and work at it.

The proposed expansion permits conventional insurers to compete among themselves and against other risk funding alternatives by working with purchasing groups.

Senator KASTEN. Mr. Lynn, let me ask you again that you summarize your statement.

Mr. LYNN. I have finished, sir.

Senator KASTEN. Thank you very much.

Mr. Leslie Cheek, vice president of Federal affairs, Crum and Forster Insurance Companies.

Mr. Cheek.

Mr. CHEEK. Mr. Chairman and members of the subcommittee. The Crum and Forster Insurance Companies are the nation's second largest writers of general liability insurance. We were one of the handful of property casualty insurers that actively supported the 1981 enactment of the original Product Liability Risk Retention Act.

We supported that legislation because its early proponents had clearly demonstrated a need for competitive alternatives to commercial product liability insurance, and because it offered a means of mobilizing additional sources of capital for the risk-spreading function while respecting longstanding Congressional policy that the business of insurance should be taxed and regulated by the States.

Likewise, in view of the serious capacity shortage that will afflict the casualty insurance business for perhaps the next rwo years, we are prepared to support legislation that would extend the principles of the original act to those other lines and classifications of liability insurance in which there is a demonstrated lack of competition in the commercial insurance marketplace.

As we did in 1980 with respect to product liability, we acknowledge now, with respect to nurse-midwives, asbestos abatement contractors, and those involved in the handling and disposal of hazardous wastes, that there are sound social policy reasons for encouraging the utilization of private capital to spread the legal risks associated with these activities.

We believe that the risks associated with these activities have become too unpredictable to insure at rational prices, but our perception may be wrong, and we do not see any principled reason why those engaged in these activities should not be given an opportunity to prove it by collectively committing their own assets to the risk-spreading process.

Indeed, those who choose to take advantage of this opportunity may discover, as America's physicians have through their "bedpan mutual" medical malpractice insurance companies, truths that we consider self-evident: the importance of reserves for incurred, but not reported (IBNR), claims; the explosive impact of judge-made law; and the astonishing transaction costs associated with "winning."

But the legislation before you is not grounded in need; it does not require any risk retention group that wishes to offer "liability insurance' to its members to demonstrate to any authority that there is an absence of competition for their business either among insurance carriers fully subject to their State's regulation or among insurance carriers deemed worthy by their State to write business that the fully-regulated market cannot provide.

The bill before you would unleash, upon a regulated market that mambers of this Congress have criticized for its absence of regulatory discipline, entities subject to the financial discipline of a single, perhaps

distant, State, but free of many of the restraints imposed upon commercial insurers, to compete in a $9 billion market without any showing whatsoever that there is an absence of competition among regulated carriers.

We are not afraid of competition in markets where we and our competitors have been shown, for reasons right or wrong, to be incapable of providing the type or amount of coverage that our customers desire. But we cannot accept legislation, like S. 2129, that would, at one and the same time, promote competition in regulatory laxity among States competing for risk retention group domiciles and encourage unregulated adverse selection of risks against both admitted and non-admitted markets subject to State law.

The underlying virtue of S. 2129 is its recognition of the infeasibility of repeated amendments to the original act whenever commercial competition for one or another line or classification of liability insurance disappears.

Its fatal defect, in our judgment, is the absence of any requirements that a risk retention group establish a need for it to offer a particular line or classification of coverage because the demand for it cannot be met in the regulated admitted or non-admitted commercial insurance marketplace.

As commercial insurers, we rail repeatedly against State insurance regulation which we believe inhibits our ability to compete for business. But we also recognize that State insurance regulation is aimed at assuring both our commercial policyholders and claimants against them that we will be able to honor the promises we have made.

Our plea to you this afternoon is not that you foreclose competition against us, but rather that you require those who would compete against us to do so only upon a demonstration that we cannot, or will not, meet the needs of their constituents.

Thank you for this opportunity to present our views.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. We have heard some concern expressed that this legislation would allow anyone to form a risk retention group regardless of the severity of their insurance problems.

If we can establish reasonable criteria which individuals must meet before they can form such a group, without defeating the purpose of the bill, why shouldn't we allow these groups to compete with the established industry?

Answer. In today's deregulatory climate, one could argue that competition in the provision of property and casualty insurance, unfettered by State or other regulation, is in the public interest. However, State insurance regulation does not exist to restrict entry into the property-casualty insurance business, a fact best evidenced by the presence of 3,500 property-casualty companies in the marketplace. Rather, insurance regulation exists to assure that the promises made by an insurer to its policyholders will be honored when the policyholder or third-party claimant seeks recompense for his or her loss.

The insurance industry viewed the original Produce Liability Risk Retention Act as a means of meeting the short-term need of product manufacturers for a predictable and stable source of product liability coverage. Likewise, we view the current proposal as one intended to meet needs for alternatives to commercial insurance in lines and classifications of liability insurance that are not currently available, or available on reasonable terms and conditions, in the commercial insurance marketplace.

The industry does not believe that the legislation should create entrepreneurial opportunities where there is no absence of competition in the regulated insurance market. There is no public policy justification for subverting State insurance regulation in lines and classifications of liability insurance coverage for which there is ample competition in the regulated commercial insurance market.

Merely establishing reasonable criteria which individuals must meet before they can form a risk retention group, such as the relatedness of their activities, begs the question of why such groups should be free of regulation designed to protect the public (and risk retention group members) from unsound risk-spreading arrangements.

The insurance business has no objection to competition from risk retention groups, so long as those groups are required to play by the same rules and shoulder the same public protection obligations as are imposed on commercial insurers.

Had the industry been consulted in the drafting of S. 2129, it would have recommended that the bill specify those lines and classifications of liability insurance that would be eligible for risk retention group treatment. Instead, the bill opens up the entire $9 billion liability insurance market to largely unregulated entities which may operate in all states subject to the regulation of only one state. In the absence of a showing of need for such unregulated competition, we believe the bill is both unsound and contrary to the public interest.

Question 2. Some groups have expressed concern about the potential risk of insolvency faced by the risk retention groups that would be formed under this bill. Others have persuasively pointed out that requiring state-by-state approval or, in effect, veto authority would really make this legislation too cumbersome to provide effective relief.

Would it make sense to establish some sort of national financial and other standards which perhaps might be enforced and monitored on the Federal level?

Answer. State insurance regulation provides an adequate framework within which risk retention groups may operate. There is no need for "national financial and other standards which perhaps might be enforced and monitored on the federal level."

Commercial insurers are required to obtain "state-by-state approval" of their activities, and we see no reason why the same obligations should not be imposed on risk retention groups. Indeed, because of the lack of experience of risk retention group organizers in the liability insurance business, the need for state solvency regulation is even more acute than it is for experienced commercial insurers.

Just because a particular form of regulation is "cumbersome" does not mean it should be preempted for the convenience of group self-insurers. Indeed, one might ask why those who seek to form risk retention groups do not form their own mutual or reciprocal insurance company under State laws.

Most State insurance regulatory statutes are reasonably similar in their approach to the major elements of insurance regulation, and do not constitute a significant burden on interstate commerce. Thus, there is no need for national standards of insurance regulation. By the same token, however, there is little justification for cre-

ating a 49-State regulatory vacuum for the convenience of a risk retention group that chooses to charter itself in a State with regulation which may be less effective than that in other jurisdictions.

Question 3. Has the insurance industry developed any estimates of the amount of insurance premium that would be diverted from the regular insurance market into the risk retention groups?

Answer. There is no basis on which to estimate the amount of insurance premium that could be diverted from the insurance market into risk retention groups. In our judgment, the amount of such diversion would be insignificant if the bill were narrowed to authorize the creation of such groups only in lines or classifications of liability insurance unavailable on reasonable terms and conditions in the commercial insurance marketplace.

The legislation makes an effort to limit the conditions under which groups may be formed, by requiring a similarity of activity on the part of potential group members. This restriction, along with the difficulties inherent in persuading competitors to share each other's liability risks, is likely to be sufficient to limit the impact of risk retention groups on the commercial insurance market.

Question 4. Do you expect that this bill will increase competition in the insurance market and help bring down insurance prices?

Answer. We do not expect that enactment of S. 2129 will significantly increase competition in the insurance market, nor do we believe that its enactment will help bring down insurance prices.

The commercial insurance industry is already highly competitive, and will remain so as long as it is allowed to be competitive by its regulators. Current price increases in inadequately priced lines and classifications of coverage will, in those lines and classes that remain sufficiently predictable, restore rate adequacy and insurer profitability, and will encourage insurers to compete for business that might otherwise be written through risk retention groups.

For the foreseeable future, insurance prices are likely to mirror underlying loss and expense experience, which presumably will be the same for risks of a similar nature, whether they are insured commercially or through risk retention groups. Thus, the mere existence of risk retention groups should have very little impact on insurance prices for the foreseeable future.

Question 5. Since the Commerce Committee is exploring a variety of solutions to the overall insurance problem, I would like to ask a question indirectly related to the issue at hand.

Do you feel that my joint and several liability amendment in product liability cases would alleviate the difficulty businesses have in finding adequate and affordable product liability insurance.

Do you feel it would be appropriate to extend this concept to other areas, such as environmental issues, and would such a move have any effect on the price and availability of other types of liability insurance?

Answer. We have already written to Senator Pressler in support of his proposed amendment eliminating joint and several liability in product liability actions. A copy of the letter is attached. As indicated in the letter, we believe strongly that joint and several liability is the most significant impediment to the predictability of liability insurance risk.

We also would support extending the elimination of the joint and several liability doctrine to other areas, particularly environmental liability, and we are convinced that the elimination of the concept would have a favorable impact on the price and availability of all types of liability insurance.

Senator KASTEN. We have a couple of questions. The basic question seems to be what is it that you are testifying against here today that in a sense you were all, Mr Connolly, testifying for a couple years ago?

It seems to me a number of the arguments, particularly the arguments by Mr. Shaffer, were similar to the arguments that I read about in the late 1970s and early 1980s that we worked with through the Risk Retention Act.

What is it that so concerns you about what we look upon as a logical expansion?

Mr. CONNOLLY. As a matter of fact, we are not testifying against the original Risk Retention Act and would ask that the product liability portion remain exactly as it is. Those were options put before you. Nor did we request you change it as to product liability.

Mr. Lynn says there is nothing fundamentally changed about this proposal as compared with the 1981 proposal, but that is not correct. In 1981 the proposal was put forward so that there was a community among those people who might form a risk retention group. The requirement was that they be manufacturers of products. The conception behind that was that essentially we would be dealing with a similar product so that you might have the National Association of Wholesaler Distributors forming a group, essentially their characteristic would be the same.

Here the requirement appears to be that you be in an association, business or corporation. The fact is that this regulation is so broad that the various mutual companies, some of which are among the largest companies you have in the U.S. today providing commercial liability insurance, would be able to cancel their licenses in the various States, reform in Vermont, and then sell their policies in the various States without any State regulation because there is no consistent quality for the regulated group.

The definition of "group" for one thing seems to be so broad that I think you might be able to sell high liabiity insurance based upon a "frequent fliers" membership. That is the problem.

One problem is that it is so broad that in ways which I do not think even we have really thought out yet it reflects traditional State regulation which has worked well. That is why we are able to say leave it for product, move it into those areas where I think there is unanimity that the existing market cannot respond.

Senator KASTEN. Senator Gore

Senator GORE. Thank you very much, Mr. Chairman.

Mr. Lynn, you testified that your organization more or less supports this bill.

Is that correct?

Mr. LYNN. That is correct.

Senator GORE. What are some of the hazards you see confronting a group of businesses that get together and try to form one of these risk retention groups?

Mr. LYNN. The first hazard is getting commitments to sufficient capital in order to make it a viable insurer. In the middle of February another representative of the NAIB described the excess liability insurer, called ACE, which has been created by a group of 25 or 30 of the largest American companies by simply putting $10 million into the kitty, each, in addition to whatever premiums they might pay.

They can do that, but the ordinary busline operators, chemical distributors, nurse-midwives, truck equipment manufacturers, distributors, cannot do that and probably need to go beyond their own associations

because there simply are not enough members, so the access to a very broad group of people and the ability to solicit them by paying attention to the securities laws only so far as one does not commit fraud, would facilitate collection of that money.

A second difficulty would be underpricing which causes any insurance company to lose money.

A third difficulty would be obtaining the underwriting, engineering and claim expertise which is necessary to run any insurance venture successfully.

Senator GORE. Above and beyond the provisions in the various State laws that would still apply here, there are certain market disciplines that would discourage undercapitalized groups from getting into this.

Is that right or wrong?

Mr. LYNN. Several things.

One, the extent to which the State of domicile decides that the group has to be funded in accordance with whatever its business plan of operation is.

The second is the natural desire of the potential insured to not be buying a worthless piece of paper and that of his agent or broker not to be the instrument of selling him that worthless piece of paper.

Senator GORE. That is a matter of substantial concern to the other three members of the panel, is it not?

Mr. LYNN. Yes. I think we need to be careful here to make sure that we are filling a need and not providing an opportunity. Any industry is full of unscrupulous people who might take advantage of a way to promote a scheme that the public would suffer from.

That is part of our concern.

Senator GORE. Mr. Shaffer, you testified, and I found your statement very interesting and informative, that your organization is basically opposed to this bill; is that correct?

Mr. SHAFFER. No, we are not basically opposed to it. We feel that it needs to take care to be sufficiently regulated to avoid the unscrupulous operator, yet to avoid the Federal regulation versus the State. It is a very delicate situation.

Senator GORE. You would have to vote against the bill as it is currently drafted?

Mr. SHAFFER. We have some amendments that we feel would allay certain of our fears. We will present those to you.

Senator GORE. If it turns out that those amendments for some reason do not pass, you still would go ahead and counsel us to vote for the bill?

Mr. SHAFFER. It is your call, Senator. I am going to be on the firing line. I have to be careful that I am not selling worthless paper of a bankrupt company. Going to your insured and telling him you do not have anything is a heart-rending and expensive proposition.

Senator GORE. You are caught between your customers and the large insurance companies. I know that it has been a particularly difficult time for the independent brokers and also for the independent agents. The position of some of these customers, as you well know from talking

to them, is that they cannot get insurance at all, it is unavailable at any price, and they want the flexibility to come and try to set up one of these groups. They do not really appreciate somebody who refuses to give them insurance.

Mr. SHAFFER. The group that is probably giving you the most heat now is nurse-midwives. Let me use those as an example.

There are only 2,800 of them. They are used to paying $3,000 a year for insurance. Their income is maybe $25,000 from what I read in testimony. That only provides an $8.4 million fund. It is a small group.

I think the insurance industry is kind of rearing back from trying to correct the social problems, not that this is a social problem, but the litigation problem. It is such a small group that no one is willing to stick his neck out for a small group.

I agree we have a very serious problem. We would like to see a way for them to resolve it.

Senator GORE. My time has expired. We are having to move very rapidly because of the desire to move this bill out of committee in a timely manner.

Thank you very much.

Senator KASTEN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you.

You said, Mr. Shaffer, that the role of the Government is only to provide relief where relief is really needed no more, and you also said, no less. We are the Federal Government and relief is really needed.

Are you saying that we should take your amendments and it will be all right? What about those counties without insurance?

Mr. SHAFFER. We are aware there is a severe problem.

Senator ROCKEFELLER. I know you are aware. All I hear you guys saying is that you are always concerned, except you seem to also oppose what we are trying to do.

Mr. SHAFFER. Part of my concern is Federal regulators getting their nose under the tents. We are happy with State regulation. We see this as an opening crack and I would hate to see that follow as a result of this legislation.

We are not carrying water for the insurance companies. We are as mad at them as you are, believe me. I do not know what the answer is.

Senator ROCKEFELLER. You say:

"Believe me, there is no one more frustrated by the current availability/affordability crisis than the property/casualty insurance agent."

Mr. SHAFFER. That is right. I said it.

Senator ROCKEFELLER. Where is the solution? Mingo County has had no insurance since last November.

Mr. SHAFFER. Knowing the cyclical nature of our industry, this problem will be resolved in short order.

Senator ROCKEFELLER. Mr. Lynn says it will take a year and a half for this crisis to solve itself.

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Mr. SHAFFER. He is not getting quotes from companies every month. I just lost my largest account yesterday——

Senator ROCKEFELLER. When is it going to settle down?

Mr. SHAFFER.——because another company cut the price on liquor liability.

It is settling down now. The companies are willing to sell stock because apparently the public thinks they have a gold mine and they will make money just by selling stock in their firms, creating more capital and providing more volume.

When you have limited volume, you are going to cut out risks you know are hazardous, and write pig iron underwater. That is what happened as we restricted the availability of insurance to where the tough risks are going without insurance and hopefully our amendment will cure part of this.

Senator ROCKEFELLER. You want to make sure that there is no mismanagement?

Mr. SHAFFER. That there is a true need and not an opportunity for somebody to get in the insurance business without regulation.

Senator ROCKEFELLER. Certifying the unavailability of insurance, you are for that?

Mr. SHAFFER. Yes. That statement only addressed the admitted market. This is non-admitted.

Senator ROCKEFELLER. When I was Governor of West Virginia, State insurance departments, including our insurance department behaved as if they were under Gramm-Rudman-Hollings. They were, by necessity, committed to working under a limited budget. Insurance departments of every State, have been under Gramm-Rudman for the last 5 years. We only had 18 to 20 people in our State insurance department in West Virginia. We are just beginning to find out what that is like here in the Federal Government.

You are telling me that the State insurance departments of West Virginia, California and other places are going to have to certify unavailability of insurance.

That reminds me a little bit when I was in the State Legislature, our barbers came in and said, "We want to pass a bill in which all future barbers would have to be college graduates."

I thought that was terrific. It is a little bit like locking yourself in and keeping everything else out. You have to certify unavailability of insurance.

Mr. SHAFFER. The agent does that. If the agent goes to the marketplace and he is not able to find a market, he submits to the risk retention group statements that he was unable to get coverage in the regular market and this is the only recourse.

Yes, it would be great to have a place to put these people. Right now it is a shame, a lot of the problem is unavailability. In the down market when the prices were 20 percent of what they were supposed to be, people made up the unavailability statements so that they could get the lower price through the surplus lines market rather than the admitted market.

Senator ROCKEFELLER. If this passed, you would not be happy?

Mr. SHAFFER. No, I would be perfectly happy with it.

Senator ROCKEFELLER. If it passed, you would be somewhat less than perfectly happy. The current situation is that nothing has passed and the people do not have community coverage. This is not an academic pursuit.

A year ago it would have been academic to me because nobody was talking about it. Now insurance is all that everybody is talking about when I go back to my State. These people are going bare.

We are here to try to do something to be helpful. You are saying do not pass S. 2129 unless you amend it because it really would not be helpful.

My question to you: Is it not worse for companies and municipalities and public bodies to be without insurance? Is that not a greater and more costly alternative than the alternative of. S. 2129, amended or unamended?

Mr. CONNOLLY. Senator——

Senator ROCKEFELLER. I was asking Mr. Shaffer, Mr. Connolly.

Mr. SHAFFER. I agree. I do not think our amendments are that extreme. In all reality, I do not think this will solve the problem. I think the regular marketplace will get back in shape before this is ever a reality, in my personal opinion.

Mr. CONNOLLY. I would like to point out among other States, 10 States already have facilities that are providing insurance through State run, mechanisms where insurance has been found to be unavailable. That is for medical practice, through joint underwriting associations.

We do not particularly like those, but many commissioners have the ready power to make such determinations.

Secondly, most of the impediments to municipal formation of groups arise from State prohibitions on municipalities sharing their debts.

We have testified in several States in favor of removal of those provisions to facilitate pooling by municipalities. We recognize that within States that is a necessary and possible response, but allows them to still be regulated either by the State municipal controllers or by the insurance department.

So, we have supported those recommendations. We feel those are sound responses.

Finally, in the State I come from, New York, where we have a few municipalities with similar problems, we put together a marketing assistance program under which insurers are taking those liabilities.

I should not have said "finally," because once more in New Jersey, the State has had major difficulties because of environmental exposures and some Consitutional, MONEL type problems. In that State we assisted or at least did not oppose legislation which would create a fund to provide insurance for municipalities in that area.

So, we are working. We do not want this problem to become worse than it is. We want to get solutions. When we cannot provide them, we would like to offer ways in which it can be done.

What we are concerned about is the overbroad sweep of this proposal as it now stands.

Senator ROCKEFELLER. Mr. Chairman, I see my time has run out.

Senator KASTEN. Thank you, Senator.

I think it is clear that we are going to have an ongoing discussion with a number of representatives at this table as we develop this legislation. Nevertheless, it is clear to me that the need for this kind of legislation or something very similar to it is equally clear and equally urgent.

I would like to thank the members of the panel for their testimony.

The next panel includes Mr. Mullen, Ms. Ehrnman, Mr. Harkavy and Mr. Williams.

The first witness on this panel is Michael Mullen, counsel.

Mr. Mullen.

STATEMENTS OF MICHAEL J. MULLEN, COUNSEL; KAREN EHRNMAN, RN, MPH, GOVERNMENT RELATIONS COORDINATOR, AMERICAN COLLEGE OF NURSE-MIDWIVES; JON HARKAVY, DIRECTOR, GOVERNMENTAL AFFAIRS, RISK INSURANCE MANAGEMENT SOCIETY, INC.; ANTHONY C. WILLIAMS, DIRECTOR, DEPARTMENT OF RETIREMENT, SAFETY, AND INSURANCE, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. MULLEN. Thank you, Mr. Chairman.

It is a privilege to have the opportunity to testify on S. 2129, the Risk Retention Act, to cover all general liability insurance risks other than Workman's Compensation.

I have in the past represented risk retention groups and purchasing groups, but I am testifying today at the request of the Committee and not on behalf of Crowell and Moring or its clients.

On March 4 I testified before the committee and set forth the reasons why I believed Congress should broaden the Risk Retention Act.

The U.S. Chamber of Commerce in a survey of its members determined that 13 percent of them were unable to obtain liability insurance.

The Insurance Services Office in a report issued in 1985 indicated, according to my recollection, that there would be some $50 billion shortage in "capacity" in the property and casualty insurance market.

Unless Congress takes action to broaden the Risk Retention Act or in the alternative provide some Government insurance program, which I would strongly oppose, many businesses, trade associations, non-profit organizations and municipalities will be left without adequate liability insurance coverage.

Mr. Chairman, at the beginning of this hearing you mentioned a letter received by the committee on behalf of several organizations, the National Association of Wholesaler-Distributors, the National Association of Manufacturers, National Association of Machine Tool Builders, the American College of Nurse-Midwives, who are testifying today, the Small Business Legislative Council, the United Bus Owners Association, the National Restaurant Association, and the Special

Committee on Workplace Product Liability Reform. All of these organizations are concerned that restrictions on the authority of risk retention groups would seriously impair the ability to utlize a broadened Risk Retention Act.

Let me assure the committee that I am concerned about fraudulent activities in the insurance industry. I am concerned about the insolvency of both insurance companies and risk retention groups. But I would urge this committee to use caution in adding requirements that will make it, as a practical matter, very difficult to organize risk retention groups.

I believe there is a real shortage of liabiity insurance today. The insurance industry operates somewhat like a bank. It has certain lending authority. When that lending authority is used up, then under Government regulations, it cannot make any additional loans. To some extent, the insurance industry capacity problem is similar.

I want to give you an analogy. What we have is similar to a shortage of fuel. Some people are saying, well, we need to use wood stoves because we do not have enough fuel oil. Some are saying wood stoves are dangerous, there might be a fire.

Congress has a difficult choice here. People are going to freeze or we are going to use wood stoves. Some are saying: "I'm sorry wood stoves are dangerous. Some of you will just have to be cold and risk freezing to death." I say that's nonsense. First, let's see if the wood stoves are, in fact, risky. And, second, if they are, let's take reasonable steps to make them safe. But, don't prevent their use and cause large numbers to remain cold.

That is the problem that some insurance clients have today. They cannot get any insurance in the commercial market. There are four basic choices that I see available.

The States can create joint underwriting associations in which insurers are forced to accept risks they do not want to insure voluntarily. Most commercial insurers do not like those JUAs.

You can create a Federal reinsurance program, but that would be a disaster. It would subsidize dangerous products and activities and pose grave risks for the Federal budget.

You can do nothing and just leave a lot of organizations without the ability to obtain insurance.

Or you can broaden the Risk Retention Act.

Of those choices, I think broadening the Risk Retention Act is the most beneficial. Companies are either going to go without insurance if you do not pass the Risk Retention Act or they are going to go offshore and form groups like ACE and the other kinds of organizations which are totally exempt from regulation by the States.

Let me explain the concern I have about the adoption of the needs test. If you have to demonstrate, and I state this partly from experience I have had in representing some risk retention and purchasing groups, if you have a needs test, you have to prove that in every single State you cannot get insurance in the commercial market.

For a small group like the nurse-midwives, that becomes a significant, if not, insurmountable, burden.

The other problem is if you have an organizaton and you want to set up a risk retention group, if there is any admitted insurance company that offers coverage, even for a million dollars, then all the members of that organization would be barred from joining the group in any State where this coverage was offered.

The other thing is, would you have to prove this every year?

There is a great deal of effort required to create a risk retention group. You have to raise capital from your members, get consultants and get approval from the licensing State. If the au;thority to operate is so uncertain that its unknown even after the group has raised the required capital and obtained authority from the licensing State, and, you have to prove need every year in every State, I do not think anyone would ever undertake the effort needed to create a group.

I understand the concerns about solvency. I understand the concerns about providing protection against fraud. I would hope that the committee would not make this act so cumbersome that as a practical matter no one can utilize it.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF MICHAEL J. MULLEN

Mr. Chairman, Members of the Committee: It is a privilege to be given the opportunity to testify on S. 2129 to expand the Risk Retention Act to cover all general liability insurance risks other than Workers' Compensation.

I have previously testified before the Committee and set forth the reasons why I believe Congress should broaden the Risk Retention Act. The United States Chamber of Congress in a survey of its members determined that 13 percent of them were unable to obtain liability insurance. The Insurance Services Office in a report issued in 1985 indicated that there would be a 50 billion dollar shortage of capacity in the commercial property-casualty market. Unless Congress takes action to broaden the Risk Retention Act, or in the alternative provides government insurance—an action I strongly oppose—many business, trade association, nonprofit organizations and municipalities will be left without adequate liability insurance coverage.

Potential opposition to this legislation could come from:

Insurance agents, who might be concerned about losing commissions if policies are sold on a group basis through a single agent to the members of a risk retention or purchasing group;

Insurer concerns, insurance trade associations, some of whose member insurance companies are worried about losing market share to risk retention groups.

State insurance commissioners who could, understandably, oppose any limitation on their regulatory authority.

1. *Insurance agents.*—Insurance agents could express concern about the solvency of risk retention groups and their own potential liability should a risk retention group fail. Hopefully, these concerns will be abated as the purpose of this legislation is identified. With respect to the liability of agents, no agent is compelled to act as an agent for a risk retention group. That liability can be avoided completely by any agent who feels the potential risk from such representation is unreasonable. No agent should ever represent any insurance carrier or any risk retention group, if that agent has reason to believe that the insurer or group is in a financially unsound condition. Agents could be concerned that they will not know about the condition of a risk retention group because it is only regulated in one state. But their concern about risk retention groups is part of a general problem agents face about insurer solvency. Mission Insurance and Carriers, and some 40 other insurance companies became insolvent in 1985 under the current system of state insurance regulation. Agents who relied on state's insurance departments to advise them as to which companies were in a financially impaired condition found many of their policy holders being caught short by the sudden insolvency of their carrier.

Insurance agent groups might suggest that capital surplus requirements should be imposed on risk retention groups. The stated justification for these requirements is to assure that these groups do not become insolvent. Many members of the business community, especially small businesses, believe that these minimum requirements are intended to be set at a high-level to restrict the creation of risk retention groups. I am not philosophically opposed to minimum, capital and surplus requirements, but if that step is taken, Congress will be crossing the Rubicon regarding federal regulation of the business of insurance.

2. *Insurer concerns.*—Some insurers could be concerned about competition. If the Risk Retention Act does not create an unfair market situation this concern, hopefully, will be abated. In most states with file and use statutes there has been a de facto deregulation of commercial liability insurance rates. To the extent, however, that rate regulation is excessive or unnecessary, the criticism is not addressed to the Risk Retention Act but to excessive regulation of commercial liability insurance rates under state law. The same is true with respect to approval of policy forms. Here, I would agree, state regulation is excessive and unnecessary. Mutually consenting insurance buyers and insurance underwriters should be free to agree on whatever coverage terms and exclusions they find suitable.

There is a third area of potentially unfair competition, the state guaranty funds. These funds require, on a post-assessment basis, payments, up to certain limits, by admitted insurers into a fund to pay claims made against an insolvent insurance company. An examination of insurance guaranty funds shows that they are not a factor regarding competition. Since 1969 when insurance guaranty funds began widespread operation through 1984, the net assessment of admitted insurance companies to the guaranty funds was $393.2 million. The total amount of net premiums written by property casualty insurance companies between 1975 and 1984 was more than $780 billion. Therefore, the amount paid into state guaranty funds was approximately 1/20 percent of the total net premiums written. It is obvious that this

miniscule percentage of the total property casualty insurance premiums written will not affect competition between admitted insurers and risk retention groups.

In sum, if the insurance industry is competitive, as I believe it is, then risk retention groups should not create unfair competition. Only one risk retention group has been formed in the last five years.

Let me relate some personal experiences to the Committee. I have been involved with one organization which, within the last year, seriously explored establishing a risk retention group. When they analyzed their exposure to liability, the amount of capital they would need to establish a group, and the premiums they would need to assure the payment of potential claims which might be made against their members, they decided not to establish a risk retention group. I know of at least three other groups which have conducted extensive feasibility studies regarding the formation of risk retention groups. In each case after examining their options, these organizations chose not to form a group and to remain in the commercial liability insurance market.

3. *State insurance commissioners.*—The National Association of Insurance Commissioners ("NAIC") opposed the Risk Retention Act of 1981. Testimony and arguments they are making today simply repeat the same concerns that were considered and rejected by the Congress in 1981.

The NAIC contends that adequate regulation cannot be established without minimum capital and surlus requirements, regular financial examinations, supervision of investments, adequate loss reserving, and other regulations. Each risk retention group is subject to regulation of these matters under the laws of state in which it is licensed. To the extent that it claims that regulation of these matters is inadequate under the laws of some states, that is really indictment of state insurance regulation per se, not of the Risk Retention Act.

The NAIC may contend that the integrity of insurance products cannot be maintained without the regulation of policy forms and the determination of the adequacy of insurance rates. This argument is not persuasive. First, the non-admitted insurance market, and the surplus lines part of that market, constitute at least $2.3 billion in premiums which are not subject to any regulation of policy forms or rates. Congress should understand that there is a large segments of commercial insurance which is not subject to any state regulation of policy forms or rates and which is not subject to state guaranty fund laws. More than 20 states have "Industrial Insured Acts," which exempt certain commercial insurance buyers that have a minimum annual premium, a minimum number of employees, and a full-time risk manager, from state laws regarding rate regulation and policy forms.

The Risk Retention Act is not a radical departure from state insurance regulation, it is simply an extension of unregulated markets that will allow insurance purchasers who do not qualify as industrial insureds and who are not otherwise able to establish sophisticated and complicated off-shore captive insurance companies the freedom and flexibility to procure adequate liability insurance.

The claim by the NAIC that state regulation is needed to regulate the insurance rates of a risk retention group should be placed in context. Mr. Chairman, there are persuasive reasons why this argument should be rejected. First, I would assure solvency not by regulating rates (directly), but by having the licensing state assure that the total premium volume, capital, surplus reserves, etc. are sufficient to assure the sound operation of the group. Second, it is impractical to require a small group to prove to 50 state regulators that its rates are adequate, not excessive, etc. The burden outweighs the benefit. Moreover, if individual states were to require changes in the rate schedule by lowering the rate, they might jeopardize the soundness of the group. And, any such rate differences would create a perception of unfairness among group members from different states. The overriding factor is that such regulation is unnecessary and burdensome.

The NAIC could be concerned that insurance buyers will be inadequately protected unless the Unfair Trade Practices Acts and advertising regulations are applied to risk retention groups. This concern can be alleviated. Risk retention groups are self-insurance pools created by the voluntary action of trade associations and other organizations which establish a group self-insurance program. They will only establish these self-insurance pools if they determine that the terms of coverage and the premium schedule are in their interest.

The members of these groups usually have their own risk managers, in-house counsel, and outside counsel who are fully capable of reviewing the terms of coverage and comparing the premiums offered by a risk retention group against those offered in the commercial market, and making an informed business decision as to whether they wish to join such a group. Heavy regulation by state insurance departments of commercial insurance buyers is unnecessary. It is well established that

state insurance departments are under-funded and shorthanded. They should devote their resources to protecting homeowners, automobile owners, students, widows and orphans. Commercial insurance buyers should be free to enter into insurance agreements that they believe are in their own interests.

The NAIC argues that in some states, premium taxes go into the state's general fund and not enough money is authorized or appropriated for the operation of the state insurance department. This is not an argument against the Risk Retention Act, it simply indicates that states must do more to adequately fund state insurance regulation. The NAIC also makes an argument about the penalties for failure to comply with the Unfair Claim Settlement Practices Acts. To the extent that the remedies or penalties under those acts are not sufficient, it is up to the states to strengthen them.

With respect to reports regarding liability losses and expenses, this requirement is made with respect to certain state laws regarding special reports of product liability losses and expenses. The Act explicitly states that each state may request a risk retention group to provide copies of its annual financial reports filed with the state in which it is licensed as an insurance company. Each state in which a group operates can obtain a complete financial report on the group's operations.

The NAIC suggests that while manufacturers have been sophisticated enough to understand the risk involved in forming a risk retention group, small businesses and nonprofit organizations do not have the knowledge and sophistication necessary to make these judgments. I consider this statement regarding the financial capabilities of small businesses and nonprofit organizations to be incorrect. These small businesses know far more about insurance than they are given credit for and have the counsel of expert consultants and brokers.

There could be risks of failure by a risk retention group. There are risks of failure by all businesses and there are certainly risks of failure by regulated commercial insurance companies! More than 40 insurance companies regulated by state insurance commissioners became insolvent within the last year.

The issue regarding the Risk Retention Act is not whether we can establish some fail-safe regulatory system that can prevent any possible insolvency. The issue before Congress is whether it wishes to take any action that will facilitate the ability to form self-insurance pools. More than 10% of American businesses do not have liability insurance today. Congress can take some action to facilitate the ability to establish self-insurance pools. Or it can do nothing. Or it can adopt all the restrictions of insurance agents, trade associations and state insurance regulators propose so that the Act will be so burdensome that no risk retention groups will ever be formed.

Every legislative decision like this requires choices. What degree of regulation is reasonable and necessary so that risk retention groups will be under adequate supervision, while at the same time not being so burdensome that no group will ever be established.

I believe that the framework of the 1981 Risk Retention Act establishes reasonable guidelines for the regulation of risk retention groups. The only issue with regard to the Risk Retention Act is whether, if the admitted insurance companies are incapable of providing sufficient capacity in terms of coverage needed by commerical insurance buyers, those buyers can have a reasonably feasible and simple option available to self-insure their liability insurance risks.

4. *Conclusion.*—Mr. Chairman, in closing, I would like to make the following observations. The reason many business organizations support the expansion of the Risk Retention Act is because they believe it will broaden the base of available insurance and help with regard to insurance affordability. (In many cases the action by insurers is justified from their perspective. But, buyers are always upset.) Let me quote from a leading study of insurance markets an explanation of this treatment of commercial insurance buyers:

It is quite possible that certain risks may be accepted by the admitted market, while identical risks may be refused. The reason for such discrimination is that there are too many risks in this class for the admitted market to handle.

S. WEESE, NON-ADMITTED INSURANCE IN THE UNITED STATES 7 (1971).

Regulation of commercial liability insurance by state regulators cannot, alone assure available and affordable commercial liability insurance to American businesses. Other alternatives are necessary. Congress should act to facilitate them.

Mr. Chairman, if 10% of American businesses have no liability insurance, then there are no insurance policies to look to for the payment of claims. There is no insurance guaranty fund that even comes into play at all. Congress is faced with a

very simple question. Is society better off with a large percentage of commercial insurance policyholders with no liability insurance? Or is it better if companies are insured under self-insurance pools which allow businesses which cannot as a practical matter obtain affordable or available commercial liability insurance, some opportunity to insure and spread their risks?

I think the answer is clear. The Risk Retention Act should be expanded.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. What will happen to the various groups represented on this panel if the bill does not become law?

Answer. If the Risk Retention Act does not become law, then some firms and nonprofit organizations will be unable to obtain liability insurance from commercial insurers. The Insurance Service Office in a 1985 report indicated that over the next three years there would be a $62 billion shortage in the capacity of commercial insurance companies to provide needed coverage. Unless additional options for self-insurance programs are enacted, many firms and organizations will be forced to go without adequate insurance or to establish off-shore captive insurance companies.

Question 2. Do you perceive that the groups formed under this bill would be at greater risk of insolvency than those groups that were formed under the original Risk Retention Act?

Answer. No. On the contrary, the amendments incorporated in S. 2129 as reported by the Committee add additional authority for state insurance commissioners to examine risk retention groups and assure that they are not operating in a "hazardous financial condition" under circumstances that involve a clear risk of insolvency. Therefore, under the amendments to the Risk Retention Act set forth in S. 2129, there is more regulation and more protection against insolvency.

Question 3. Some groups have expressed concern about the potential risk of insolvency faced by the risk retention groups that would be formed under this bill. Others have persuasively pointed out that requiring state-by-state approval or, in effect, veto authority would really made this legislation too cumbersome to provide effective relief. Would it make sense to establish some sort of national financial and other standards which perhaps might be enforced and monitored on the Federal level?

Answer. For the reasons set forth in my testimony, I believe that state-by-state approval or veto authority regarding the operation of a risk retention group would make the law unduly burdensome and would effectively preclude the organization and operations of risk retention groups. I would also conclude, however, that it is unnecessary to establish federal regulations to assure adequate regulation of these groups. It is my belief that the additional oversight authority granted to state insurance commissioners under the amendments adopted by the Committee (and contained in S. 2129 as reported) provide sufficient regulatory authority to address these issues.

Question 4. Since the Commerce Committee is exploring a variety of solutions to the overall insurance problem, I would like to ask a question indirectly related to the issues at hand. Do you feel that my joint and several liability amendment in product liability cases would alleviate the difficulty businesses have in finding adequate and affordable product liability insurance? Do you feel it would be appropriate to extend this concept to other areas, such as environmental issues, and would such a move have any effect on the price and availability of other types of liability insurance?

Answer. Legislation such as your joint and several liability amendment would be helpful in addressing one tort law issue that makes it difficult for insurance underwriters and actuaries to accurately and fairly price liability insurance. The doctrine of joint and several liability applies to many types of tort claims. In addition to product liability, it presents problems when applied to the liability of municipal governments. Therefore, it is clearly appropriate to study the need for extending your amendment to other areas of tort law.

Senator KASTEN. Mr. Mullen, thank you very much.

The next witness is Karen Ehrnman, government relations coordinator for the American College of Nurse-Midwives.

Ms. Ehrnman.

Ms. EHRNMAN. Thank you, Senator Kasten and Senator Rockefeller.

I appreciate this opportunity to convey to you why nurse-midwives across the country fully support S. 2129. We are appreciative as well for the support of the clients whom we serve and many of the health professionals with whom we work.

In the few minutes I have I would like to explain why for nurse-midwives passing S. 2129, as written, is so important to us.

It appears that most of the panel preceding this one agreed that nurse-midwives are unable to purchase insurance through any mechanism. We have tried the traditional market.

In addition, we have tried going to all the States. We have spoken with all the State insurance commissioners and in only one State, New Jersey, have we been able to purchase private insurance.

With regard to a joint underwriting authority, although we have lobbied successfully to be included under the joint underwiting authority in many of the States in which it is available the premiums have been excessive.

For example, in New York State the premium is $72,000. Nurse-midwives make $25,000. Therefore, I think most will agree that for nurse-midwives the only option available to obtain insurance is for us to form our own insurance company and we are in the process of trying to do that.

We have been advised that in order to do this, we must become licensed in every State. This will take years. Nurse-midwives do not have years to achieve this.

We have been struggling for the last year to find insurance. As I stated, we have been unable to. It has taken us one year to systematically go through each of these options and realize our only option is forming our insurance company.

During this year our members have been able to obtain insurance through two nursing groups. This insurance runs out this spring and early summer since both of the insurers who are providing the insurance for the nurses have now excluded nurse-midwives from their policies.

I would just like to mention that timing is very important to us and why we are urging very quick action on this bill. As I mentioned, our insurance runs out this spring and early summer. Therefore, we must have an insurance company set up by this summer which can write insurance in all 50 States. S. 2129 will help us do that.

Just a few words about some of the speculation and fears of insurers about groups such as nurse-midwives going forward and forming our insurance company. We have hired the best consultants and technical assistance that we can find in the United States.

In addition, nurse-midwives are going to be required, if we get this insurance company off the ground, who make approximately $25,000, to borrow $6,000 to get this company off the ground. They have an investment in making this company operate soundly.

Although, as previous panel members have testified, there are only 2,500 certified nurse-midwives in the United States, they will be paying premiums of between three and $4,000.

The rate of claims against nurse-midwives has been extraordinarily low. Only six percent of certified nurse-midwives have ever been sued.

We intend with our new company to further strengthen the management aspect of the company, to strengthen the peer review which is already in process, and to maintain our excellent record. That is why we believe we will be able to have a good company.

Thank you.

[The statement follows:]

STATEMENT OF AMERICAN COLLEGE OF NURSE-MIDWIVES

Good afternoon. My name is Karen Ehrnman and I represent the American college of Nurse-Midwives. Nurse-midwives across America support S. 2129. In addition, many of our hundred thousand or more clients are supportive of this bill on our behalf, as are large numbers of professional colleagues.

This testimony will describe why this bill is so very important to the future practice of nurse-midwifery in the United States. Briefly, since last summer the American College of Nurse-Midwives, the professional association for nationally certified nurse-midwives, has been unable to obtain a blanket insurance policy for its members. This denial of insurance was because of general conditions in the insurance industry and not because of our members excellent professional performance. Suits have been filed against only six percent of all nurse-midwives—a number not considered high among medical professionals. Our earlier testimony before this committee (March 4, 1986) chronicles each step we took to try to obtain insurance of this type. We were unsuccessful.

Additionally, nurse-midwives went to the states to become included in joint underwriting associations (JUAs) which provide professional liability coverage for physicians, hospitals and other designated health care providers where traditional markets have declined. Although several state JUAs are actively covering nurse-midwives, these premiums are prohibitively expensive. For example, the proposed New York state premium is nearly $72,000. Nurse-midwives average salary is $25,000. At the state level, we have also spoken with almost all 50 state insurance commissioners. Although many of them have tried to help us, their hands have been tied. Only one state—New Jersey—has been able to provide insurance from a private company. It is clear that no insurance company wants to write professional liability insurance for nurse-midwives. (Again, I refer you to March 4, 1986 testimony on reasons given by insurers for not wanting this business.)

Therefore, our only option at this time is for nurse-midwives to band together to form their own independent insurance company. Again, I stress, we see no choice. The process of systematically looking at each option available to us and eliminating those which were not workable has taken almost a full year. (We were officially notified last May that our policy would not be renewed on July 1, and we were apprised of this possibility earlier last spring.) During this year we were fortunate to find that many of our members could temporarily purchase insurance through two other nursing organizations. Since the insurers of both of these nursing groups have subsequently written into the policies an exclusion of nurse-midwives, there are no companies at all writing this coverage at the present time.

From a survey of our membership, we know that this temporary coverage ends this spring and early summer. Therefore the new insurance company must be operational in all 50 states by summer. As you know, under the insurance laws of virtually all the states, a new company could not write insurance unless it became licensed in each of these states. This time consuming process could take several years. Again, we need to have the new company operational by summer.

S. 2129, if passed by Congress and signed by the President, would facilitate this process. The bill would allow nurse-midwives to become licensed as an insurer in one state and then write insurance in all fifty states. This is the only way that we will be able to set up a company within the required time frame.

I would also like to take this opportunity to present our views on some proposed amendments to this bill under discussion this week.

Nurse-midwives have hired some of the very best technical insurance consultants and legal consultants to deal with this problem. The business plan is designed as a long-term commitment of nurse-midwives to this proposed company. The company will be owned by nurse-midwives. They will need to borrow possibly $6,000 to provide the necesary funds for premiums and capitalization. In addition, our risk management program will be strengthened. Only six percent of nurse-midwives have ever been named in a suit. Nurse-midwives participate in peer review and the American College of Nurse-Midwives both certifies and decertifies nurse-midwives. We intend to maintain this excellent record. This, in turn, will contribute to the financial stability of the company. The amounts of coverage, premium levels, capital requirements and other financial concerns have been analyzed by several actuaries. We believe that this is the proper manner to make these determinations. We believe that review of this information by one insurance commissioner is sufficient.

For our purposes, any additions to the bill that require discussion with all fifty state insurance commissioners are superfluous and would represent an unnecessary burden. We have already spoken about this problem with each insurance commissioner and they, in turn, have confirmed what we knew. There are no insurance

companies in the United States interested in writing a professional liability insurance policy for nurse-midwives. In addition, we would not want to be in a position that if offered insurance in a state, like New York for $72,000, that we would be unable to go forward with our own affordable insurance option.

Therefore, please pass S. 2129 quickly. Help us get it passed by the full Senate and House of Representatives and help us form this insurance company by this summer.

I would be happy to answer any of your questions.

Senator KASTEN. Thank you very much.

I might say your group is unique, but you are not alone in terms of the numbers of people who are concerned about the immediacy of these kinds of problems. You may know of some other groups in the day care business who are in the position you are right now and have run out of opportunities, as have a large number of municipalities, obviously.

They have been shoppiong in 50 states, and they have been out there trying for a significant amount of time.

The next witness is Mr. Jon Harkavy, government affairs director, Risk Insurance Mnagement Society, Inc.

Mr. HARKAVY. Thank you.

I am giving this testimony on behalf of RIMS which is a non-profit association for risk and insurance managers of commercial and industrial enterprises.

Our 3,800 organizational members represent more than 76 chapters throughout the United States and Canada, and include not only 92 percent of the Fortune 500 list, but many smaller businesses, towns and service corporations as well.

I want to stress that as consumers of commercial insurance, we strongly support the passage, unamended, of S. 2129.

The first thing I would like to put in the record are the findings of RIMS' affordability/availability survey that our members conducted during 1985. Although we should point out that those who are insisting upon such proof to qualify the Risk Retention Act are akin probably to the Wizard of Oz asking Dorothy for the broom of the Wicked Witch of the West to prove their worthiness.

I would like to give you a quick summary of what is happening in the commercial insurance market and, quite frankly, we are much more concerned about the exploitation of the market by the present insurance carriers than we are about scams that could operate under S. 2129. Let me give you a summary.

A. Primary General Liability: 1,114 respondents. Availability was curtailed and premiums increased significantly.

Availability: Much difficulty or unavailable for 24 percent of the respondents.

Premiums: Increased over 100 percent for 36 percent of the respondents.

Coverage conditions. Somewhat or highly restricted for 50 percent of the respondents.

Sectors Particularly Affected: Computers, hospitals, governmental entities, transit, unviersities.

B. Umbrella/Excess Liability: 1,125 respondents. Availability was severely curtailed, and premiums soared, these problems affected every industry sector.

Availability: Much difficulty for 64 percent of the respondents; unavailable for 13 percent.

Premiums: Increased between 210 percent to 500 percent for 36 percent of the respondents, over 500 percent for 25 percent of respondents.

Limits: Down between 76-100 percent for 18 percent of the respondents.

Conditions: Highly restricted for 19 percent of the respondents. Somewhat restricted for 51 percent.

Sectors particularly affected: All.

C. Directors' and Officers' Liability: 964 respondents. Limits decreased and deductibles rose for many respondents, apparently forcing them to self-insure this exposure. Any coverage they located carried significantly higher premiums, and more restrictive conditions.

Availability: 41 percent report much difficulty or unavailable; 12 percent did not purchase.

Premiums: 36 percent report increase of over 200 percent.

Conditions: 16 percent report highly restricted; 35 percent report somewhat restricted.

Sector particularly affected: All.

I think the one thing that should also be stressed is that not only is it affecting all sectors of the community, but there is a real interest among our members in looking for a group solution as a response.

Seventy-one percent of the respondents seeking to renew umbrella/excess coverage expressed interest in a group solution, 55 percent of the directors and officers, 67 percent of the respondents seeking environmental impairment liability.

We are in the process now of setting up a net working bank where groups with similar liability needs could use the Risk Retention Act, as amended with S. 2129, to form such a group.

I should note by requiring as a condition of exemption the licensure of a risk retention group under a State law, S. 2129 would create a powerful incentive of these groups to become licensed on shore. This would produce corresponding spin-off benefits in terms of capital, employment, and taxes for the U. S. economy, both Federal and State.

I would like to respond just briefly, if I could, to people bringing in their concerns about the consumers insurance and about potential claimants.

Regarding unidentified claimants, it is the harsh truth the primary purpose of State insurance department regulation is to protect the policyholders and not the claimant. The overwhelming majority of policyholders purchase insurance, not by legal mandate, but as a sound business practice. Your organization receives no guaranty fund protection with purchases of insurance from a non-admitted carrier.

Even if insurance is purchased from a licensed carrier, the security afforded by guarantee fund is tenuous at best. Indemnification limits encompass a range as low as $25,000 to $100,000 per day.

I think the thing that I particularly want to stress is that you have to remember that under S. 2129 a risk retention group still has to get licensed in one State. I would like to give you a brief outline, if I may, that will not take more than a minute.

To form an association captive, it has to be one that must be wholly already in existence. It must have at least $500,000 capital and surplus and can write only the risk of the association members.

In the case of an industrial insured captive, the parent organization must generate $25,000 in insurance premiums, utilizing the service of a full-time insurance risk manager, employ at least 25 full-time individuals and have at least $750,000 in capital and surplus.

What we are suggesting here is that even under the most liberal requirements of capitalization laws in the United States, the license requirements for capital for risk retention groups are very strict.

Thank you.

[The statement follows:]

STATEMENT OF JON HARKAVY, DIRECTOR GOVERNMENTAL AFFAIRS, RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

Mr. Chairman and Members of the Committee, I thank you for this opportunity to testify on behalf of the Risk and Insurance Management Society, Inc. (RIMS) in support of S2129, the Risk Retention Act Amendments of 1986. I am Jon Harkavy, Director of Governmental Affairs for RIMS, a non-profit association for risk and insurance managers of commercial and industrial enterprises, public entities, and service organizations. Our 3800 organizational members, represented in more than 76 chapters throughout the United States and Canada, include not only 92% of the Fortune 500 list but many smaller businesses, towns and service organizations as well.

RIMS strongly opposes suggested amendments to S2129 which would have the impact of further limiting the lines of insurance which a risk retention group could offer its members or which would hinder a risk retention group's formation or operation. One such amendment which RIMS learned might be offered to S2129 would permit each state insurance department to require that a risk retention group prove the unavailability or unaffordability of each line of coverage it intends to offer its members, as a precondition of being permitted to operate in that state. Such an amendment, if incorporated into the legislation, would effectively gut S2129 and the existing Risk Retention Act. Lest it be misunderstood, RIMS is not objecting to the right of any state to impose whatever reasonable restriction it wishes on a risk retention group seeking to become licensed or chartered as an insurance company within its jurisdiction. Where RIMS does object is subjecting a risk retention group, which has met the licensing requirement of a particular state, to potentially 49 different insurance availability/affordability threshold tests as a precondition to operating on a multistate basis. Indeed, this dilemma was the impetus behind the enactment of the original Risk Retention Act of 1981 whose legislative history states:

"The state laws have other regulatory standards which make it difficult for trade associations or small business groups to utilize them. For example, one state's trade association captive must have an annual premium of over $1 million; it is subject to approval of its rates; it must establish that the insurance it provides is otherwise unaffordable or unavailable—price competition is not sufficient justification; it must be located in the state; and it would still be subject to the regulatory barriers imposed by other states for risks situated in those states * * *. Federal action is necessary because experience has shown that individual state legislation cannot facilitate the formation of self-insurance groups. Individual states can only enact legislation affecting their respective insurance law requirements. The practical effect of these laws is to prevent product sellers located in several states from forming such groups."

RIMS will offer into the record the results of our insurance availability survey demonstrating the disastrous condition of the 1985 marketplace. However, RIMS must emphasize that we see no valid public policy purpose in amending S2129 as narrowly as possible to reflect present market coditions. Why must policyholders, claimants and the public be subject to an insurance crisis before a group self help solution can be afforded under the Risk Retention Act? As the commercial liability insurance crisis has made us all painfully aware, the purchase of insurance is not like a capital improvement which the buyer can put off for another year. Governmental services have been cut, business activities have been restricted, and professions have been adversely affected by insurance unavailability. Our corporations, municipalities, service sectors and professionals cannot sit back and wait for the chaotic insurance marketplace to right itself. We cannot remain totally vulnerable to future drastic premium increases and insurance unavailability. Similarly, legitimately injured claimants cannot time their injuries to coincide with insurance availability. While S2129 is not a panacea, it does offer some help for an entity seeking coverage, and a claimant requiring compensation.

Risk retention groups are not going to surplant the traditional insurance industry. As always, when the insurance marketplace can offer reasonable coverage at affordable rates the policyholder will look first to the traditional insurance carrier. To the extent that a risk retention group can operate more efficiently than its carrier counterpart it would put welcome competitive pressure on the insurance community to lower its own transaction costs.

S2129 would not undermine the state regulation of insurance. To operate as a risk retention group under the legislation, the group must be chartered or licensed as an insurance company and authorized to engage in the business of insurance under the laws of a state. Furthermore all risk retention groups must submit to an examination by the state insurance commissioner in any state in which the group is doing business. This is to determine the group's financial condition if:

1. The commissioner has reason to believe that the risk retention group is in a financially impaired condition, and;

2. The commissioner of the jurisdiction in which the group is chartered has not begun or has refused to initiate an examination of the group.

In short the regulatory tools are incorporated in S2129 for any state insurance department which wishes to oversee the operation of a risk retention group in its state.

For those on the Committee that are seeking statistical justification of the unaffordability/unavailability of the lines of insurance that can be offered by a risk retention group under S2129, I submit for the record the Insurance Availability Survey results which RIMS recently conducted of its members. The management consulting firm of Tillinghast Nelson and Warren Inc., assisted RIMS in designing the survey, tabulating data and interpreting results.

ABOUT THE SURVEY

RIMS designed a survey form which requested information about the conditions encountered in the most recent renewal of 12 lines of commercial insurance coverages. Specific questions were identified for coverage availability, cost, limits, deductibles and terms and conditions. The form also requested demographic information about each respondent, which was used for computing and evaluating responses. A copy of the questionnaire is included in the record. The survey was mailed to 3,709 RIMS members on January 2, 1986. The results presented here were developed from the 1,176 responses received by February 14, 1986.

RESPONDENT PROFILE

Firms ranged in size from $1 million in annual revenues to $96 billion. Respondents are located in 46 U.S. states and the District of Columbia. Virtually every sector of the economy was represented. Industry groups which responded well include banks, hospitals, universities, oil and gas producers, electric utilities, and retail grocers. In addition, many governmental entities responded. A listing of the individual industry groups and their Standard Industrial Classification (SIC) codes is included in the submission.

MARKET CONDITIONS BY LINE OF COVERAGE

The survey originally sought information about 13 common lines of commercial insurance—some of these are not included in this analysis because of low responses. A summary of market conditions for each line of insurance is presented below. Virtually all the respondents who indicated "Did Not Purchase" probably attempted to locate coverage.

A. Primary General Liability: 1,114 respondents. Availability was curtailed and premiums increased significantly.

Availability: "Much Difficulty" or "Unavailable" for 24% of the respondents.

Premiums: Increased over 100% for 36% of the respondents.

Coverage conditions: "Somewhat" or "Highly" restricted for 50% of the respondents.

Sectors particularly affected: computers, hospitals, governmental entities, transit, universities.

B. Umbrella/Excess Liability: 1,125 respondents. Availability was severely curtailed, and premiums soared. These problems affected every industry sector.

Availability: "Much Difficulty" for 64% of the respondents; "Unavailable" for 13%.

Premiums: Increased between 201%–500% for 36% of the respondents; over 500% for 25% of respondents.

Limits: Down between 76%–100% for 18% of the respondents.

Conditions: "Highly" restricted for 19% of the respondents; "Somewhat" restricted for 51%.

Sectors particularly affected: all.

C. Directors' & Officers' Liability: 964 respondents. Limits decreased and deductibles rose for many respondents, apparently forcing them to self-insure this exposure. Any coverage they located carried significantly higher premiums, and more restrictive conditions.

Availability: 41% report "Much Difficulty" or "Unavailable"; 12% did not purchase.

Premiums: 36% report increase of over 200%.

Conditions: 16% report "Highly" restricted; 35% report "Somewhat" restricted.

Sector particularly affected: all.

D. Product Liability: 237 respondents. Limits and deductibles were stable, and premiums increased somewhat for some respondents. Availability of reasonable coverage presented problems, as conditions of coverage became more strict and several chose not to purchase it at all.

Availability: 24% had "Much Difficulty" in locating coverage, and 24% did not purchase.

Premiums: 37% report increase of over 100%.

E. Professional Liability: 420 respondents. Premiums increased for those respondents finding coverage. Limits and deductibles were fairly stable, but coverage conditions were fairly restricted.

Availability: 26% report "Much Difficulty" in locating, and 11% report "Unavailable". 31% did not purchase.

Premiums: 29% report increase of over 200%.

Limits: 35% report decrease over 25%.

Sectors particularly affected: construction, financial institutions, hospitals, services, governmental entities, universities.

F. Environmental Impairment Liability: 585 respondents. Few respondents located coverage. What insurance was available carried much lower limits, fairly higher premiums and deductibles, and quite restricted conditions.

Availability: 37% report "Unavailable"; 18% report "Much Difficulty" in locating. 14% were not renewed, and 35% did not purchase it.

Premiums: 36% report increase over 200%.

Limits: 39% report decrease over 75%.

Deductibles: 26% report increase over 200%.

Conditions: 44% report "Highly" restricted; 26% report "Somewhat" restricted.

Sectors particularly affected: chemicals, computers, wood products, machinery, metals, mining, governmental entities.

G. Property Damage: 1043 respondents. Many report significant premium increases and curtailed coverage, and some found availability was restricted. Limits and deductibles remained stable.

Availability: 18% report "Much Difficulty".

Premiums: 35% report increase between 51% and 500%.

Conditions: 30% report "Somewhat" restricted.

Sectors particularly affected: retail grocers, governmental entities.

H. Flood/Earthquake: 757 respondents. Availability and limits were significantly curtailed. Some faced fairly steep premium increases, although deductibles and conditions did not change much.

Availability: 40% report "Much Difficulty" or Unavailable".

Premiums: 24% report increase over 200%.

Limits: 17 report decrease over 75%.

Sectors particularly affected: electric utilities, wood products, machinery, governmental entities.

CONCLUSIONS OF SURVEY

The survey results confirm that the insurance market has deteriorated sigificantly. This deterioration has affected some lines of insurance and some industry groups more than others. Few signs indicate that the situation will improve soon—in fact, it may worsen in some areas. There is also evidence that:

Insurance market conditions deteriorated rapidly and drastically during and after the 4th quarter renewals in 1984. Premiums increased rapidly, limits decreased, and retentions increased. This deterioration continues to the present.

Almost every coverage studied created a serious problem for insurance buyers. In some lines, such as auto liability, only premium increases concerned respondents. For others, such as flood/earthquake (earthquake), coverage has been difficult to obtain, at generally insufficient limits. In some cases, especially in umbrella/excess and directors' and officers' liability lines, adequate coverage and reasonable limits, retentions, and premiums have been difficult, if not impossible, to find.

A surprising number of respondents indicated that they did not purchase coverages: 12% for directors' and officers' liability, 24% for product liability, 31% for professional liability, and 35% for environmental impairment liability (EIL). This may have adverse implications for the indemnification of futures claimants.

The insurance market crisis has affected virtually all sectors of the U.S. economy. Some industry groups such as government, universities and hospitals have suffered much more than others. Other sectors, including general manufacturing and wood products, have nearly as many difficulties. Many others have faced significant prob-

lems with respect to specialized coverages, such as EIL in the chemical and mining sectors, or professional liability in construction and financial institutions. Small and large firms alike have experienced similar difficulties.

Perhaps most significant is the number or respondents interested in seeking a group solution to their insurance problems. Not surprisingly the greatest interest in a group approach was for lines of coverage hardest and most expensive to obtain. For instance, 71% of the respondents seeking to renew umbrella/excess coverage expressed this interest. In a group solution; 55% of those seeking to renew directors' and officers' coverage expressed an interest in a group solution, and 67% of the respondents seeking environmental impairment liability insurance expressed this interest. Interest in group solutions for other lines of coverage also was high, ranging from 24% to 52%.

RIMS is in the process of using the survey as the foundation for establishing a networking mechanism through which our members with similar insurance needs can explore the possibility of group insurance pools. We believe that S. 2129 would be used by many RIMS members and other policyholders to establish risk retention groups. By requiring, as a condition of exemption, the licensure of a risk retention group under a state law, S. 2129 would create a powerful incentive for these groups to become licensed onshore, rather than in some foreign domiciliary. This would produce corresponding spin-off benefits in terms of capital, employment, and taxes for the U.S. economy, both federal and state.

In conclusion S. 2129 is pro-consumer legislation which will benefit policyholders, claimants, and society as a whole. While the bill is worthy of passage at any time, its expeditious enactment is particularly crucial in these times. RIMS urges the Committee to swiftly approve S. 2129 without weakening amendments.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. What will happen to the various groups represented on this panel if this bill does not become law?

Answer. To many insureds, the group solution facilitated under S. 2129 is the most viable option to obtain insurance coverage unavailable or unaffordable in today's marketplace. Without the risk retention group option many insureds will have only two bleak options:

A. "Go bare" or underinsured and pray that nothing happens;

B. Discontinue or drastically limit operations or professional practices with significant liability exposures.

The enactment of S. 2129 would afford many insureds with a significant self help alternative to an insurance marketplace which has deserted them.

Question. Do you perceive that the groups formed under this bill would be at greater risk of insolvency than those groups that were formed under the original Risk Retention Act?

Answer. Risk Retention Groups formed under S. 2129 would have no greater risk of insolvency than groups formed under the original Risk Retention Act. In fact, the amendments added to S. 2129 when the legislation was reported out of the Senate Commerce Committee strengthen the ability of state insurance departments to monitor the solvency of risk retention groups operating or licensed in their states.

Question. Some groups have expressed concern about the potential risk of insolvency faced by the risk retention groups that would be formed under this bill. Others have persuasively pointed out that requiring state-by-state approval or, in effect, veto authority would really make this legislation too cumbersome to provide effective relief.

Would it make sense to establish some sort of national financial and other standards which perhaps might be enforced and monitored on the Federal level?

Answer. As stated in question #2, adequate regulatory tools exist in S. 2129 which would permit any state to monitor the solvency of a risk retention group. RIMS sees no need for the regulation of risk retention groups on federal level. However, one may consider the establishment of a minimum capital and surplus requirement which a risk retention group must meet to operate under S. 2129. I believe that most states regulating risk retention groups require minimum capital and surplus of $750,000 to $1,000,000.

Question. Since the Commerce Committee is exploring a variety of solutions to the overall insurance problem, I would like to ask a question indirectly related to the issue at hand.

Do you feel that my joint and several liability amendment in product liability cases would alleviate the difficulty businesses have in finding adequate and affordable product liability insurance?

Do you feel it would be appropriate to extend this concept to other areas, such as environmental issues, and would such a move have any effect on the price and availability of other types of liability insurance?

Answer. RIMS can think of no other area of tort reform so critical as the need to restrict the application of the joint and several liability doctrine. Corporations, professionals, municipalities, and service organizations are frequently brought into litigation in which they had little or minimum involvement, and forced to shoulder the entire award because they had "the deepest pocket". It is a distortion of the concept of negligence when damages can be awarded against the defendant with the greatest financial resources rather than on the entity's or individual's degree of fault. Given the relative ease that a minimum degree of negligence can be established, the joint and several doctrine from an insurer's perspective means that it is insuring not only the policyholder, but literally every potential tort feasor with insufficient financial resources.

While RIMS, as a representative of the commercial insurance consumer cannot speak for the insurance industry, we believe that the repeal of the joint and several liability doctrine would impact favorably on the availability and affordability of liability insurance. We commend you for your amendment to S. 1999 in this regard, and hope such an approach is adopted in areas besides product liability as well.

Senator KASTEN. Thank you, Mr. Harkavy.

Mr. Anthony C. Williams, director, Department of Retirement, Safety and Insurance, National Rural Electric Cooperative Association.

Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

On behalf of the 1,000 rural electric cooperatives operating in 46 States, I would like to strongly endorse S. 2129 and urge its prompt consideration by Congress.

I do not believe anyone doubts that there is a crisis facing all purchasers of liability insurance with rate increases of 100 to 1,000 percent and with severe reductions, in some cases disappearance, of insurance coverage.

We believe S. 2129 is a positive step forward in solving this problem by making it easier for businesses to form their own purchasing or insuring group.

When rural electric cooperatives were first formed 50 years ago to bring light and power to rural America, a major problem threatened their development, the cost and availability of liability insurance. This concern in part brought about the creation of our national association and until recently we believed that the insurance problem had been satisfactorily resolved.

While the property and casualty industry has had its good and bad cycles over the years, we have never had the difficulty in obtaining adequate coverage at a cost commensurate with the risk as we have today.

Despite the size of the rural electric market and many years of reasonable experience, we are faced with accepting coverages we previously considered inadequate and unacceptable for record premiums.

Rural electric cooperatives in the past have solved their problem by observing the cooperative principals to pool our members' resources and share our risks. This has brought a wide range of services within

the reach of every rural electric system that might not otherwise have been available to them.

Passage of this bill would open new avenues to attack the problems facing us and other purchasers of liability insurance. The broad exemptions from various State laws and regulations is, in our opinion, needed to extend insurance capacity.

In fact, since the exemption from State law and regulation would be available only to those participating in the group, it would not be in their economic self-interest to proceed in any but the most financially prudent manner.

Further, we believe the bill keeps in place those areas of State law for the protection of the public. We do not support the removal of any State laws necessary to protect the public. We believe that the bill will considerably broaden the means for businesses and the insurance industry to attack this problem.

In conclusion, Mr. Chairman, we support this bill fully and congratulate you and the sponsors of this bill and offer any assistance at our disposal.

[The statement follows:]

Statement of the National Rural Electric Cooperative Association

Mr. Chairman and members of the Subcommittee, I am Anthony C. Williams. I am the Director of the Retirement, Safety and Insurance Department of the National Rural Electric Cooperative Association (NRECA) and the Administrator of the various pension and welfare programs sponsored by NRECA for its members. NRECA is the national service organization of the approximately 1,000 rural electric systems operating in 46 states. These systems bring central station electric service to approximately 25 million farm and rural individuals in 2,600 of our nation's 3,100 counties. Our various programs provide pension and welfare benefits to 110,000 cooperative employees and dependents in those localities and casualty insurance for the cooperatives.

The purpose of my appearance before you today is to strongly endorse S. 2129 and to urge its prompt consideration by Congress. The current crisis facing all purchasers of liability insurance has drawn attention to annual premium increases of 100 percent to 1,000 percent or more, yet we face another situation which is just as bad, or possibly even worse, the inability to obtain any insurance at any price. S. 2129 is a great step forward toward solving that problem by making it easier for businesses to form their own insurance group, thereby expanding liability insurance capacity. Perhaps one of the most unique features of this bill is that it ameliorates a major national problem without any additional federal spending or establishment of complex regulatory mechanisms.

THE NEED FOR EXPANDED CAPACITY

When rural electric cooperatives were first being formed fifty years ago to bring light and power to rural Americans, two problems threatened their development—the cost and availability of copper wire and liability insurance. These two concerns brought about the creation of our national association and until recently, we believed that they had been resolved. Over the last eighteen months, we have met with an unparalleled scarcity of liability insurance coverage and when it is available, it is not at an adequate or a reasonable cost.

In the area of managers, officers and directors liability insurance, coverage was almost unavailable this year for rural electric systems. It was only after much searching and pursuading that we were able to secure minimal coverage at tremendous cost. For our large Generation and Transmission Cooperatives, our members which produce and supply electricity to other rural electric systems, policies up to $50 million were commonly available for a $25,000 premium. Today, these systems find it difficult to obtain $10 million in coverage with premiums averaging $186,000. Distribution Cooperatives, our members which actually supply consumers, were obtaining $25 million policies for a $3,000 premium. Now, when it is available, $4 million policies cost $15,000. Umbrella liability policies have been available to our members both in adequate amounts and at reasonable premiums until recently. Today, umbrella liability coverage has been reduced from limits of $50 million down to $3–4 million while premiums have escalated a minimum of 300%.

In examining our problems with obtaining adequate levels of coverage, I believe you could find no clearer evidence that there is a shortage of capacity. Our members have been in existence providing the same service for 50 years in 46 states. During good and bad cycles for the property and casualty industry, adequate coverage at reasonable rates was always available. If the liability insurance market had sufficient capacity today, it would be inconceivable that our members would have these present difficulties.

FORMING POOL OR GROUP PURCHASE ENTITIES

S. 2129 offers a much needed and long overdue resolution to the problems associated with the formation of risk retention or purchasing groups. Without it, even the best financed, best managed organization could not overcome conflicting and restrictive state laws. Again, I believe our own experience is indicative of the difficulty one would face in this area.

Over the years, by observing the cooperative principles, our member systems have pooled their resources and shared their risks in an effort to meet a variety of needs. Energy research, management training, public affairs material, legislative representation, and a variety of insurance products are all provided to each of the 1,000 individual rural electric systems, who otherwise might not be able to afford these services on their own. The objective of working cooperatively to obtain the best possible product at the lowest possible cost is a challenge we face every day.

After careful review of the current federal statutes and laws of the states in which we serve, we concluded that there was no legal, practical means for us to self-insure without separately meeting the different requirements of 46 states. State after state either prohibited the mass marketing of insurance or severely restricted it. At the federal level, the Product Liability Risk Retention Act limited risk retention groups to providing product liability and completed operations coverage. As a service industry, we were not eligible. What we need to either self-insure or purchase commercial casualty insurance on a group basis is a uniform set of rules. S. 2129 provides this by allowing us to meet the needs of our members in 46 states as long as the risk retention group complies with the laws of at least one state in which it is chartered or licensed.

APPROPRIATE LEVEL OF REGULATION

While S. 2129 grants a broad exemption from discriminatory state laws, it does not, nor would we favor, the creation of an "anything goes" atmosphere. State laws which protect against unfair claims settlement practices, ensure the solvency of risk retention groups, establish loss and reporting requirements, and other legitimate consumer protection concerns should be retained. We do not believe that our member systems or any other group would be serving its own interest if it sought to avoid its responsibilities.

S. 2129 keeps in place those areas of state law for the protection of the public. S. 2129 only affects the provision of business insurance and seeks to broaden its availability. The Act does not weaken state law protection for consumers dealing with the business. Injured consumers still have recourse in state courts against a business that injures them. Insurance merely provides an additional source for payment of claims. Regulation by the insurance commissioner in one state should be sufficient to assure adequate reserving by a risk retention group. Consumers are therefore not adversely affected by the Act.

CONCLUSION

Enactment of S. 2129, the Risk Retention Amendments of 1986, will do much to reduce the wild swings we have seen in the insurance market without additional regulation. By allowing the formation of risk retention or purchasing groups on an interstate basis, a significant step toward increasing capacity and reducing the cost of liability insurance will be taken. While insurance groups of this sort may be faced with the same fundamental problem that the commercial carriers face—the arbitrariness and unpredictability of our current tort system—we would still be much better off than we are today.

We congratulate the authors and sponsors of this bill for responding promptly and thoughtfully to a major threat to our economy. We offer our assistance to you in this effort and we await your call.

Senator KASTEN. Thank you very much.

Someone suggested that those eligible to form risk retention or purchasing groups under the expanded Risk Retention Act should be limited to groups whose members are similarly situated with respect to their exposure to risk liability stemming from any business, trade product, service premises, or operations common to such members.

Your testimony has touched on this with other witnesses as well, some kind of limitation, if you would, to groups and some kind of definition of those groups.

What is your reaction to that suggestion and how would a definition which narrows the groups affect your ability to form risk retention or purchasing groups?

Mr. MULLEN. I can appreciate the concern about a group joining the nurse-midwives with machine tool builders, perhaps the risks are different. I would want to study the particular language that you read real carefully.

I am not opposed to this in concept, but, for example, I can see a group that might be composed of ski lift manufacturers as well as ski lift operators even though one is a manufacturer and one is an operator. I can see nurse-midwives joining with nurses in an insurance program.

So, I do not oppose requiring some similarity, but I would not want to see it be too restrictive so that some related or vertically integrated insurance peograms would be prohibited.

Senator KASTEN. Mr. Harkavy, Mr. Williams, or Ms. Ehrnman, do you wish to comment or differ?

Mr. HARKAVY. I share Mr. Mullen's view.

Senator KASTEN. Senator Rockefeller.

Senator ROCKEFELLER. I have no questions.

Senator KASTEN. Let me ask one other question.

A number of you have touched upon your concern for conflicting and for duplicative State regulations and requirements.

What is your response to suggestions that risk retention and purchasing groups should be made subject to State trade practices and subject to State advertising requirements?

Mr. HARKAVY. I think the basic thing you have to remember is that the Risk Retention Act was originally formed in that you have a group of policyholders, sophisticated policyholders, that do not need regulation.

Our greatest fear is that which regulates individuals that clearly do not need that protection. We are afraid that by defining these unfair trade practices, they can be used by State or other persons to defeat the implementation or formation of a risk retention group on a multi-State basis.

Ms. EHRNMAN. What I would like to encourage is just making it as simple as possible. We are willing to go to a designated State to talk with the State insurance commissioner and to meet all the requirements in that State to indicate that we have a very strong, viable, financially solvent company.

Excess requirements would create burdens which would make it impossible for us to go forth because we are a small group with limited resources.

Mr. MULLEN. I share the views of Mr. Harkavy.

When you talk about a trade association which has developed an insurance program and you are circulating information about that program to the members, I do not think you have the same potential for fraudulent advertising that you have by groups that are marketing to the public at large.

It is my understanding that in many States the insurance that is purchased through the non-admitted market or by industrial insureds or groups that participate in off shore captives are not subject to the unfair trade practices reglations.

The concern I would have is the potential for harassment. You send out a circular and all 50 States regulators are calling up and saying why do you have these terms, why do you have these words? They do this even though the document contains no false or deceptive statements and is clearly understood by those to whom it is sent.

I am aware of an organization that tried to establish a program. They said the benefit available under the program would be $1,500 per month. One State insurance department said, "That is a fraudulent and misleading document because the benefits are actually $1,505 per month. If you do not change this, we are going to cite you. We are going to issue a cease and desist order." There is a lot of Mickey Mouse involved in that. If you talk about truly fraudulent acts, I do not have any problem saying that clearly fraudulent acts should be prohibited.

Senator KASTEN. Let me ask one final question. I will start, Mr. Mullen, with you.

The Risk Retention Act, as amended by our legislation, S. 2129, would still authorize the State insurance commissionere of a non-chartering State in which a group is doing business to examine the group's financial condition.

It also would authorize that State commissioner in the non-chartering State to take action if that commissioner had reason to believe that group is financially impaired and the chartering State had not begun or had refused to initiate an investigation.

Those resposibilities are spelled out for the non-chartering State in S. 2119.

What is your response to the suggestion that because of concerns about the solvency of risk retention groups—this is related to your previous answer—that the insurance commissioners of non-chartering States should be given more authority to regulate risk retention groups?

Mr. MULLEN. As I understand it, it has been suggested they should have the right to examine a group for any reason or any time.

I share the concern of regulators about solvency. I guess my position at this time is that I believe that the provisions of the existing fact are adequate to protect against insolvency and give the State insurance commissioner adequate authority to initiate an examination whenever they have reason to believe a group is financially unsound.

I am not persuaded there is a need to change that particular provision of the law.

Senator KASTEN. Thank you very much.

There may be additional questions on this whole question of the authority of the nonchartering State insurance commissioners.

I want to emphasize the thrust of our effort, which is simply to the degree we end up with dangers for insurance carriers or for the insured, obviously, we want to work to maintain the kinds of financial solvency requirements that make sense or are reasonable.

At the same time we do not want to have such a conflicting morass of rules, regulations, red tape paperwork, whatever, so that it takes away from the overall thrust that the legislation is aimed at.

We look forward to working with you as well as the members of the first panel in terms of working our way through this kind of balance.

I would like to thank you all for your testimony. We look forward to working with you on questions and responses to those questions.

Our next panel is Lyndon Olson, Texas State Board of Insurance, who is being joined by others.

Mr. Olson, if you will introduce the other members of your panel.

STATEMENT OF LYNDON L. OLSON, JR., CHAIRMAN, TEXAS STATE BOARD OF INSURANCE; ACCOMPANIED BY EDWARD MUHL, MARYLAND STATE INSURANCE COMMISSIONER; JOHN E. WASHBURN, DIRECTOR OF INSURANCE, STATE OF ILLINOIS, REPRESENTING THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONEERS.

Mr. OLSON. Mr. Chairman, my name is Lyndon Olson. I am the chairman of the Texas State Board of Insurance , Austin, TX, and past president of the National Association of Insurance Commissioners.

Joining me today is director of insurance, John Washburn, in Illinois, and Ed Muhl, commissioner of insurance in Maryland, who is president elect of the National Association of Insurance Commissioners.

Mr. Chairman, if I may, I am the only one who has prepared remarks. If I could have a couple minutes over my 5 and take away from the other two, it would be very helpful. We did that in hopes we could cut back on our time for presentation.

Senator KASTEN. My understanding is that it was made clear you would have 5 minutes, no matter how you testified. We will give you a little bit of flexibility.

Mr. OLSON. Let me say that I come from a State unlike Senator Rockefeller's. Our department is a department of 850 employees that regulate nothing but the business of insurance, with about a million dollar budget.

I think I will point out the differentiation among States relative to regulation.

Today, you as Congressional leaders, and I, an insurance regulator, have a problem. That problem is a limited liability marketplace that has driven businesses across this nation to your door and to mine for relief. That problem is both real and political.

Having been a legislator, I am emphathetic to the real, human concerns that create the pressure to act. But as someone who has been in public life long enough to see the sometimes twisted fruits of my legislative labors, I ask that you fully recognize the grave consequences of your imminent creation.

The proposed expansion of the Product Liability Risk Retention Act of 1981, to include all liability coverage is, at best, a leaky boat in which to cast your constituents adrift. This is especially true when you give them a false sense of security of some regulatory oversight, but omit the most basic consumer protection.

We regulate, Mr. Chairman, in the States for solvency. Ability to pay claims cannot be established without adequate minimum capital and surplus requirement, regular financial examinations, supervision of investments, adequate loss reserves, limitations on premium writings to surplus and guarantee fund mechanisms.

Product integrity cannot be maintained without the regulation of forms and determinations of rate adequacy, and the marking abuses cannot be curtailed without the application of unfair trade practice acts, advertising regulations and name reservation procedures.

What may be worse than ignoring these time-tested mechanisms of the State regulation of insurance is the illusion that can be created that such regulation exists.

This illusion may be given by the minimal requirements that the risk retention group must be chartered in one State and, in any other State in which it chooses to operate, it must register, comply with unfair claim settlement practices acts, pay premium taxes, submit reports regarding losses and expenses, and submit to examinations if there is reason to believe it is financially impaired.

Surely, you as a legislative body recognize the fallacy of this approach. We as State regulators can do only what our legislative bodies allow by State, and, we can accomplish those statutory goals only to the extent that we are funded.

Who wll pay for this regulation? In our State, premium taxes go to general revenue; special taxes and fees fund our department. One such fee is an assessment for examination costs.

There is no authority in the proposed legislation that would allow us to charge a risk retention group this cost. Insurance companies cannot be assessed to pay for examinations other than their own. So, how can a non-domicillary State examine a risk retention group?

The answer is it cannot.

Consider another example—the illusion that these risk retention groups can be made to comply with State unfair claim settlememt practices acts. Disregard, if you wish, the fact that, without minimum capital and surplus and adequate reserves and sound investment, there will be no money to pay claims.

However, look at the mechanisms to enforce the unfair claim settlement acts. What is the ultimate remedy for noncompliance with these acts?

The loss of license. What kind of remedy is that when there is no license.

Consider another example—the illusion of reporting. We all know that the act requires reporting "solely to liability losses and espenses."

We all know that there is a lot more to financial statements than losses and expenses. What about investment income?

If you only look at insurers' losses and expenses alone, they would all be broke today. How do we truly know how a risk retention group is performing without full reporting?

Finally the act requires that the "group" must be licensed in at least one State, and, therefore, the domiciliary commissioner can deal with all the critical details.

Do you think that those groups are going to pick a State with adequate staffing and tough regulatory requirements?

These groups will go to the friendliest home they can find, and that friend is limited regulation.

As you know, the National Association of Insurance Commissioners opposed prior liability risk retention insurance since its inception. We felt then, as I do now, that consumers' insurance could easily be caught by this mechanism with too few guarantees for the ultimate ability to pay losses. We, and I, specifically worked with members of Congress and the Commerce Committee then to attempt to put some regulatory safeguards in place. Those safeguards have not been practical, as I have pointed out. Luckily for all of us, few manufacturers have used the Risk Retention Act for funding their product liability lawsuits. Why haven't they used it? Perhaps manufacturers have been sophisticated enough to understand the hazards of the mechanism. Pehaps they question subjecting themselves to the liability for the other members' losses.

However, this restraint will not be exercised when every mom and pop grocery store, teacher and day care center, gets solicited to be a member of such group.

How are we, as State insurance regulators, to safeguard the public with inadequate regulatory tools?

If a group truly wants to join together to insure their risk today, they can form an insurance company—I understand the timeliness and the problem attached thereto—a reciprocal exchange, or such. There are mechanisms in place to accomplish the goals.

Instead, it is proposed that Congress create a mechanism which will lend itself to the deception of the public.

How can we carry out our public trust when our ability to regulate has been undermined by Federal regulation?

It was done with ERIA, Mr. Chairman, and we are still cleaning up the mess. In Texas, we have thousands of people, literally in one scam 23,000 people, including pregnant women, elderly with catastrophic illnesses and young with cattastrophic illnesses and hospital patients, who thought they had health insurance and who now have empty. ERISA preempted State regulation. The lure of no regulation attracted the unscrupulous elements of the financial services business who estalbished multiple employer trusts, which frequently became insolvent and still are today.

The lack of adequate regulatory oversight resulted in tragic consequences for individuals who could not afford to lose their coverage.

In summary, the expansion of this act to all liability coverages will create, in my judgment, a free-for-all in self-funding of liability losses. That free-for-all will result in a short-term fix, which will consist of business expenditures in exchange for the illusion of ability-to-pay claims. While some few groups may develop and survive, the time-tested human tendency towards greed will create much more, which will develop and will fail.

Without adequate regulation, Mr. Chairman, some of these groups will victimize those who least can afford it.

I thank you for the opportunity of having us here, Mr. Chairman.

Let me further say, if I may, in light of what has gone on, that in my judgment, in the last 6 years, the insurance industry has been immensely irresponsible, undisciplined in their underwriting, and have competed themselves into the ground.

The one axiom that insurance regulators will tell you about the insurance industry is that their greed inevitably overcomes their fear, and there is no reason to believe that the greed of those who are developing risk retention mechanisms will be any different. The truth of the matter is, it is probably those insurers we are trying to regulate today who are going to jump out from under our regulation.

Thank you, Mr. Chairman.

We will be more than happy to respond to any questions you may have.

[The statement follows:]

STATEMENT OF LYNDON L. OLSON, CHAIRMAN TEXAS STATE BOARD OF INSURANCE ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Today, you as Congressional leaders, and I, an insurance regulator, have a problem. That problem is a limited liability marketplace that has driven businesses across this nation to your door and to mine for relief. That problem is both real and political. Having been a legislator, I am empathetic to the real, human concerns that create the pressure to act. But as someone who has been in public life long enough to see the sometimes twisted fruits of my legislative labors, I ask that you fully recognize the grave consequences of your imminent creation.

The proposed expansion of the Product Liability Risk Retention Act of 1981, to include all liability coverage is, at best, a leaky boat in which to cast your constituents adrift. This is especially true when you give them a false sense of security of "some" regulatory oversight but omit the most basic consumer protections:

1. Solvency, i.e., the ability to pay claims cannot be established without: adequate minimum capital and surplus requirements; regular financial examinations; supervision of investments; adequate loss reserving; limitations on premium writings to surplus; and guaranty fund mechanisms.

2. Product integrity cannot be maintained without: regulation of forms, and determination of rate adequacy.

3. Marketing abuses cannot be curtailed without application of: unfair trade practices acts; advertising regulations; and name reservation procedures.

What may be worse than ignoring these time-tested mechanisms of the state regulation of insurance is the illusion that can be created that such regulation exists. This illusion may be given by the minimal requirements that the risk retention group must be chartered in one state and, in any other state in which it chooses to operate, it must: register; comply with unfair claim settlement practices acts; pay premium taxes; submit reports regarding losses and expenses; and submit to examinations if there is reason to believe it is financially impaired.

Surely, you as a legislative body recognize the fallacy of this approach. We as state regulators can do only what our legislative bodies allow by statute, and, we can accomplish those statutory goals only to the extent that we are funded.

Who will pay for this regulation? In our state, premium taxes go to general revenue; special taxes and fees fund our department. One such fee is an assessment for examination costs. There is no authority in the proposed legislation that would allow us to charge a risk retention group this cost. Insurance companies cannot be assessed to pay for examinatins other than their own. So how can a non-domicillary state, examine a risk retention group? The answer is, it cannot.

Consider another example—the illusion that these risk retention groups can be made to comply with state unfair claim settlement practices acts. Disregard, if you wish, the fact that, without minimum capital and surplus and adequate reserves and sound investment, there will be no money to pay claims. However, look at the mechanisms to enforce the unfair claim settlement acts. What is the ultimate remedy for non-compliance with these acts? The loss of license! What kind of remedy is that when there is no license?

Consider another example—the illusion of reporting. We all know that the Act requires reporting "solely to liability losses and expenses." We all know that there is a lot more to financial statements than losses and expenses. What about investment income? If you only look at insurers' losses and expenses alone, they would all be broke today. How do we truly know how a risk retention group is performing without full reporting?

Finally, the Act requires that the "group" must be licensed in at least one state, and therefore, the domicillary Commissioner can deal with all the critical details. Do you think that those groups are going to pick a state with adequate staffing and tough regulatory requirements? These groups will go to the friendliest home they can find, and that friend is limited regulation.

As you know, the National Association of Insurance Commissioners opposed the Product Liability Risk Retention Act from its inception. We felt then, as I have reiterated now, that consumers of insurance could easily be caught by this mechanism with too few guarantees for the ultimate ability to pay losses.

We worked with members of Congress and the Commerce Committees then to attempt to put some regulatory safeguards in place. Those safeguards have not been practical, as I have pointed out.

Luckily for all of us, few manufacturers' groups have used the Risk Retention Act for funding their product liability losses. Why haven't they used it? Perhaps, manufacturers have been sophisticated enough to understand the hazards of the mechanism. Perhaps, they question subjecting themselves to the liability for other group

member's losses. However, this restraint will not be exercised when every mom and pop grocery store, teacher and day care center gets solicited to be a member of such a group.

How are we, as state insurance regulators, to safeguard the public with inadequate regulatory tools? If a group truly wants to join together to insure their risks today, they can form an insurance company, a reciprocal exchange or such. There are mechanisms in place to accomplish these goals.

Instead, it is proposed that the Congress create a mechanism, which will lend itself to the deception of the public. How can we carry out our public trust when our ability to regulate has been undermined by federal legislation?

It was done with ERISA, and we are still cleaning up the mess. In Texas we have thousands of people, including pregnant women and hospital patients, who thought they had health insurance and who now have empty pockets. ERISA preempted state regulation. The lure of no regulation attracted the unscrupulous elements of the financial service business, who established Multiple Employee Trusts (METs), which frequently became insolvent. The lack of adequate regulatory oversight resulted in tragic consequences for individuals who could not afford to lose their coverage.

In summary, the expansion of this act to all liability coverages will create a free-for-all in self funding of liability losses. That free-for-all will result in a short term fix, which will consist of business expenditures in exchange for the illusion of an ability to pay claims. While some few such groups may develop an survive, the time-tested human tendency toward greed will create many more which will develop and fail. Without adequate regulation, some of these groups will victimize those who least can afford it.

Thank you, Mr. Chairman, for the opportunity to testify.

Senator KASTEN. You are an expert. Do I understand you to feel that the tort law and the overall system here is working just fine and that the only problem is, how did you just say it, the greedy insurance companies?

Some of us have been working on these subjects for a number of years, and we are anxious to continue to work with you and with others. But you are the only witness who has said, if I understood what you said, that not everything is to blame but one group? Or is that not what you said?

Mr. OLSON. Mr. Chairman, I am the last person in the United States of America, publicly or otherwise, who would ever make that statement.

Senator KASTEN. Then I'm sorry I misunderstood you.

Mr. OLSON. I believe that it is such a calamity of forces relative to tort, relative to the insurance industry's competition in this cycle, relative to our society. The anomaly of the risk taking nation, that we want to be indemnified against everyrisk and peril is a fundamental cultural phenomenon.

I am kind of in hot water with trial lawyers, Mr. Chairman. Yesterday, I spoke to a group of about 400 people and I said I can't tell you if joint and several liability, I have a problem with the doctrine of joint and several liability today, and I know how diligently you are working on tort reform. I said to those folks that the insurers have to accept their part of the blame for competing themselves into the ground, especially in the general liability lines, for being greedy, for giving it away. The beneficiaries of their irresponsibility and their lack of discipline for the last 6 years have been the consuming-buying public. Now the worm has turned around.

The international reinsurers, as these two gentlemen will tell you, are looking at the United States, and that is where the tort system begins to mitigate in the insurance cycle. They are saying we want predictability in your system, we want some degree of predictability.

But we also, Mr. Chairman, in this country I think want to be insured against every peril that comes along. When you take those three forces, you, who sit in such a position of authority, I know are having to deal with tough, tough problems. So, please do not let me represent to you that the only problem is the insurance problem.

Senator KASTEN. If I understood your testimony, you said that what you are worried about is that people would just go to one State and it would be the State that would have the most lax, or most loose—I don't remember the term you used—the least obtrusive atmosphere, or whatever.

Is it your concern that individual chartering States cannot provide adequate protection as to the solvency of risk retention groups? And, is this concern limited just simply to risk retention groups, or do you also feel that individual States cannot provide individual protection for other kinds of insurance, over and above and different from risk retention groups?

Mr. WASHBURN. May I make an attempt at that?

Senator KASTEN. Yes, Mr. Washburn.

Mr. WASHBURN. The beauty of State regulation, as it stands today, is truly as a company expands, in terms of product line and in terms of territory, the regulatory scrutiny expands with it.

If a company operates in a very small State that has a very small staff, in actual fact, that staff probably has the capability to look at how that company in the State is operating.

As the company expands its territory and as the company expands its business, and as it moves into other States, more States take a look at it. That, really, is how the State structure works well. We are really as strong as our strongest link, not our weakest link, because as they are writing business, as they are soliciting business in different States, they now come under a new scrutiny.

Let me give you an example.

The NAIC runs a test on all insurance companies off their forms. These tests are supplied to all the insurance commissioners so they can take a look at how their company stands—in other words, whether they failed some tests, whether the NAIC thinks there is a problem with it.

In Illinois, we also run our own tests. Every company that operates in Illinois not only goes through the NAIC test, but it also goes through Illinois' tests. We are a very large State with some very large insurance companies. We have the largest insurer in the world in Illinois in State Farm Insurance.

In actual fact, we have more sophisticated rules than many other States in terms of how companies can use their assets, what they can invest in, and how they can market their product. In that light, as companies come in to Illinois to use that marketplace in Illinois, they do come under a new scrutiny, and that is the essence of how the State structure works.

I remember, when I was legislative liaison for the Governor of Illinois. Every so often, we used to short-circuit the process, the legislative process. It wasn't until I get in there that I realized why the process was there.

It was there because over time, it had developed some certain checks and balances that were necessary. The major mistakes that I remember in my tenure there were when we short-circuited the process.

Now, that did not mean we did not short-circuit the process. We still did. There were still some bills that looked better in June than they did in April, so they came up late.

But the fact of the matter is I realized that when you were going to short-circuit the process, you had to build in some special regulatory looks. You had to build in some special looks at what was going to happen at the end, because you were short-circuiting the process.

What this bill does is truly short-circuit our process of regulation. It makes us as weak as the weakest link we've got.

You have to have a really good reason for it and somehow you are going to have to set up a structure to take that into consideration because, indeed, we do not have good regulatory oversight of a company that is operating under this bill.

Senator KASTEN. We are going to conclude and there are going to be additional questions that we are going to submit and that other Senators are going to submit to your organization for the record.

But let me say that trying to deal with that particular question that you have raised, we have had the nonchartering States, as I asked the question to the panel which was appearing before you, the nonchartering States do have the ability to review, et cetera, and do have the ability to bring action under certain kinds of circumstances.

We are recognizing what you are talking about. It's just that our solution might be slightly different from yours.

Mr. OLSON. Mr. Chairman?

Senator KASTEN. Mr. Olson, do you have a brief comment?

Mr. OLSON. I apologize for interrupting you, Mr. Chairman.

Senator KASTEN. Go ahead.

Mr. OLSON. Mr. Chairman, let me point out that Texas is one of those States that has adopted the Risk Retention Act in our own legislature. I personally committed to Mr. Mullen and Mr. Swartz, when Mr. Swartz started this in 1980 and Mr. Mullen, either before you came or right after you came, when he was ably helping on this bill over here. We were working together and one of my commitments was to go back to Texas to get a model Risk Retention Act in Texas to make this thing work—even though we did not like it—to make it work if it were going to happen.

I think, Mr. Chairman, what we, as regulators, are sitting here and telling you today is that products liability is one thing. I am not worried about the Marsh McLennans, I'm not worried about the Alexander and Alexanders. I'm not worried about the big boys. They are going to make money and take care of themselves.

But this problem is so acute today that those individuals who are going to get hit the hardest are those who are going to be the least able to afford it, and we are going to have to pick up the pieces.

I think they do go to the weaker States.

To be constructive, Mr. Chairman, I would like to say to you that I think it is a bad old bill and I am going to oppose it, but the bill is going to pass, in my judgment, and I think we have to be responsible about that and do the best we can to stop barriers because, as a matter of public policy, you can make that judgment, not to create barriers to the formation of risk retention mechanisms.

But one of the things that would be greatly helpful is to allow State regulators to not just look at those risk retention mechanisms relative to their financial impairment after the fact, but give us the regulatory authority to go in and look at their books and records before those chickens come home to roose.

We are dealing on the front end of availability and affordability. But, believe me, as an insurance regulator, what we do for a living is to try to make sure that when insurance companies go broke, when self-insurance mechanisms go broke, that there is a place for those chickens to roost when they come home to light. And there is no guaranty fund here.

With that, Mr. Chairman, we will respond, as the National Association of Insurance Commissioners, to help you and your staff and members to try to constructively come up with things.

I do not want to leave the impression that we're going to say that one or two things will correct it. But we are going to try to be statesmen and stateswomen and try to be constructive in our efforts.

We may cuss you along the line, but we are still going to try to be constructive, Mr. Chairman.

Senator KASTEN. Mr. Olson, gentlemen, thank you.

I would like to announce that the scheduled markup of S. 2129 is next Tuesday, March 25. Between now and then, we are going to be working closely with a number of the people who have testified here tdoay. We are hopeful that we can come to a resolution working on a cooperative basis with a number of the people here.

That is going to mean for all the panels that we may be in touch with you with specific questions. We may be asking that you respond to us in a timely fashion with answers so that we can work out as many of the questions and problems that have been brought up today.

The hearing is adjourned.

[Whereupon, at 3:02 p.m., the subcommittee adjourned, to reconvene upon the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

The Petroleum Marketers Association of America (PMAA) appreciates the opportunity to submit for the record this statement regarding the liability insurance crisis. PMAA, formerly the National Oil Jobbers Council, is a federation of 41 state and regional trade associations representing approximately 11,000 small independent petroleum marketers (see Attachment A). Collectively, these marketers sell half the gasoline and over three-quarters of the home heating oil consumed in America today. While virtually all of these marketers are small businessmen, if one combined their collective assets, they would rank 17th on the Fortune 500's list of companies. Attached is a copy of a statistical quick reference sheet on PMAA which should assist you in understanding the scope of independent petroleum marketing (see attachment B).

As you can see, the marketers we represent have a substantial investment in their business, an investment they do not want to see lost because of the unavailability or unaffordability of liability insurance.

THE PETROLEUM MARKETING INDUSTRY

Before explaining the nature of our particular insurance problem let me first elaborate on the petroleum marketing industry and the role of the independent marketer. Petroleum marketing can basically be broken down into three levels; manufacturing or refining, wholesale distribution and retail sales.

In reality, however, the lines are not so neatly drawn. Major integrated oil companies control the vast majority of the refineries operating in the U.S. today and are the source of much of the product an independent marketer purchases. These major companies, however, do not limit themselves to crude oil production and refining. Many also both wholesale and retail gasoline, home heating oil and a wide array of other petroleum products.

Often times these major companies operate in direct competition with their wholesale customers for retail business. While this can and has created a multitude of problems for independent marketers, it creates one particular problem directly related insurance. Most of the major companies self-insure their risks, therefore, they may be largely unaffected by insurance availability and affordability problems. However, independent marketers are generally not large enough to self-insure and must purchase insurance in the open market. Theoretically, if the cost of insurance increases, that higher cost could be passed through to the ultimate consumer. However, because marketers compete with major companies that self-insure and thus do *not* experience the higher costs, many marketers may have to absorb the higher premiums.

As indicated, independent marketers purchase their product from a refiner. Many marketers then transport that product in their own trucks. In order for these trucks to be admitted to a supplier's terminal, however, they must have certificates of insurance. Without such an insurance certificate a marketer's trucks could be banned from its supply source. This would require a marketer to utilize a common carrier. This in itself would not constitute a major problem since some marketers use common carriers almost exclusively. But as can be attested to by associations representing such carriers, they also are encountering incredible problems in acquiring insurance.

Once the product is loaded into a marketer's truck it generally goes either to its ultimate destination (i.e. a service station, a commercial account, etc.), or it goes to a intermediate terminal or bulk plant owned by the marketer. These bulk plants are generally above ground storage facilities at which product is kept until it is reloaded in smaller trucks to be distributed to smaller service stations, farmers, and homeowners (in the case of home heating oil). Product that goes to the service stations, to farmers and to commercial accounts (i.e. truck fleets, cab companies, etc.) is generally stored in underground tanks.

This is a simplistic explanation of the product distribution process. Some marketers, for example, may receive product by barge or by pipeline. But this explanation does provide a framework for identifying the possible risks for which most marketers need insurance.

INSURANCE AVAILABILITY AND AFFORDABILITY

The risk perceived by many to be the greatest and the most difficult to insure for a marketer is the storage of petroleum products in underground tanks. Public attention has focused on isolated incidents where tanks have leaked and gasoline has seeped into the basements of homes. So-called "experts" have warned about the potential problem leaking underground tanks pose.

The facts, however, simply do not substantiate the magnitude of concern over the problem nor do they substantiate the difficulty marketers face in acquiring insurance for these tanks. In fact, the major insurance carrier for petroleum marketers, Federated Insurance, has indicated that in 1985 the average loss on an underground tank claim was only $29,000. This is contrasted to 1983 when the average loss was slightly over $50,000 per claim. The number of claims has, however, increased steadily. In 1985 Federated reports there were 134 claims. The lower cost per claim and greater number of claims can be attributed to the fact that marketers are taking more precautions in the installation and monitoring of their underground tank system. They are detecting potential problems at a much earlier point in time, hence the lower cleanup costs.

Marketers have an inherent economic interest to monitor their underground tanks and to take every reasonable precaution against leaks. Petroleum products are a valuable commodity. Until very recently, a marketer may have had up to $1,000 per gallon invested in product in those tanks. He has every incentive to prevent the loss of any of that product in any form.

Despite all of this, underground petroleum storage tanks are being lumped with hazardous waste disposal sites and chemical storage facilities in the eyes of many insurance companies and reinsurance companies. Many of these companies are not unwilling to do what they are supposedly in business to do, that is assume risks even when the risk is a reasonable one from a historical perspective, as is the case with underground storage tanks.

As a result of the increasing difficulty in obtaining pollution liability insurance and the higher cost when it is available, many marketers are choosing not to purchase such insurance. "Going bare" is clearly not in the long term interest of any of us.

The insurance problem which exists is not limited however, to the availability and affordability of pollution liability insurance. It includes general liability insurance as well. PMAA conducted a random sample of its members to determine the seriousnss of the liability insurance crisis. What we found was very interesting. The average premiums in 1985 paid by the independent marketer who responded to the survey was $36,175. This compares with $13,648 in 1983, a 165 percent increase in two years. The coverage obtained for this insurance decreased slightly between 1984 and 1985 and the deductible increased. The cost per dollar of insurance coverage, adjusted for deductibles, increased by 146 percent in two years. In contrast to these higher premiums the claims awards returned to marketers has actually decreased by 24 percent in the same two year period.

Of those marketers that responded, 35 percent indicated that their company had been non-renewed or cancelled in the last two years. Once cancelled, the average time it took to get new coverage was two months. Some marketers reported that it had taken them up to four months to acquire new coverage. On average, marketers received approximately two months advanced notice of cancellation or non-renewal.

While the average time frame for notices of cancellation or non-renewal seem to correspond well with the average time it takes a marketer to find a new carrier, it is interesting to note that some marketers received as little as one day's notice of cancellation or non-renewal. This obviously places that marketer in an incredibly difficult situation since he no longer has a certificate of insurance and can no longer send his trucks to supply terminals to pick up product.

Interestingly, the reasons given for termination or non-renewal varied, but the most frequent was that the carrier no longer was interested in providing coverage to our industry. This supports the theory that insurance companies in the late 1970's and early 1980's were more interested in chasing the premium dollar than they were with loss ratios. A number of companies began writing insurance at discount rates in order to acquire marketer business.

Now that the market has firmed considerably, these companies are no longer interested in offering coverage to petroleum marketers. The results of this market withdrawal have been to place an incredible strain on those few companies left which still offer coverage. One company still interested in marketer business had to suspend taking on any new business for a period of two and one half months because it had reached its acceptable capacity levels.

The other effect of the market withdrawal by companies no longer interested in marketer business is a significant lessening of competition. The results of the PMAA survey show that one company supplies coverage to over half of the marketers that responded.

POSSIBLE SOLUTIONS

Evaluating possible solutions to this dilemma is difficult, particularly for an association such as ours which is not in the insurance business. Some have argued that the easiest course is to do nothing. The insurance industry is cyclical and market conditions will eventually improve. We have difficulty accepting that argument. Many marketers may be unable to ride out this cycle. Moreover, what causes the cycle in the first instance and what steps can be taken to prevent it form recurring?

We also do not adhere to the philosophy that the source of the problem lies exclusively in reform of our tort laws or in a total restructuring of the insurance industry. We generally believe the cause of the crisis is widespread and the solutions must address each aspect of the problem.

From the perspective of the businessman we have to become better risk managers. We must take every step possible to reduce our liability and the likelihood of accidents occurring.

Our civil justice system must also be examined closely with an eye toward more accurately defining and assigning liability based more on who is at fault rather than who has the deep pockets.

The insurance industry must recognize that it has not been the model of efficiency in the past several years and that an industry with such a dramatic affect on the commerce of this country must expect federal scrutiny.

Finally, the federal government must assert itself and acknowledge that this is a problem far beyond the boundaries of individual states and that some of the problem is a direct result of laws that have been passed that, although well intentioned, have contributed to increasing substantially the liability insurance companies face.

With this in mind, PMAA would like to offer several recommendations for the subcommittee's consideration:

First, Congress should consider making available insurance for those areas which private carriers are reluctant to insure such as pollution liability. While pollution liability coverage may be currently available for underground tanks, it is available on a greatly restricted basis and there are constant rumors that it may not be available at all in the future. Some industries already are unable to obtain pollution liability coverage. To deal with this problem Congress should make available such insurance with a problem similar to the Federal Flood insurance or riot insurance programs.

Secondly, our civil justice system must be modified considerably. While PMAA is still analyzing the recommendations of the Tort Policy Working Group at the Department of Justice, we believe that many of their suggestions may have merit. These include the retention of fault as the basis for liability; that joint and several liability be eliminated; that punitive damages and pain and suffering awards be limited to a fair and reasonable amount; and that alternative dispute resolution mechanisms be developed.

Finally, Congress should consider the enactment of federal minimum standards for state regulation of the insurance industry. This would bring about a level of consistency in state regulation. In addition, the antitrust exemption insurance companies have under the McCarran-Ferguson Act should be re-examined to determine that extent to which the exemption is still justified. The question of whether the antitrust exemption has been a contributing factor to the current crisis should also be examined. The fundamental question is—Should an industry with as great an impact on millions of businesses as the insurance industry has to be totally exempt from any consistent federal scrutiny?

STATEMENT OF THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

The National Association of Independent Insurers (NAII) is a trade association representing approximately 500 Property and Casualty Insurance companies. Our

members range in size from the very largest national writers to the smallest one state writers. Among our members are mutual and stock companies and reciprocal exchanges. Their marketing strategies range from providing the widest range of insurance products to those specializing in a relatively few product lines.

From the inception of the Product Liability Risk Retention Act in 1979 to its enactment in 1981, NAII consistently and strongly opposed that legislation.

Today, NAII wishes to go on record in opposition to any expansion contemplated in S. 2129.

NAII was born during the pivotal period of the insurance industry's history that resulted in the enactment of the McCarran-Ferguson Act. Historically, it has been a firm advocate of the right of individual states to regulate the business of insurance. Although no system of regulation is perfect, NAII is convinced that state regulation provides a superior system for addressing the problems of insurance. We must, therefore, oppose the breach of the McCarran-Ferguson Act and the preemption of state regulation implicit in S. 2129.

We are aware of availability problems in the marketplace and acknowledge some industry contributions to these problems. However, we believe, a "quick fix" (as proposed by S. 2129) is not the proper response. In fact, enactment of S. 2129 could delay or prevent the sorely needed state tort reform legislation which would provide the most effective and permanent solution to the liability problem. S. 2129 does not address these underlying problems.

S. 2129 alleges to embrace state regulation by requiring that a Risk Retention Group be licensed in at least one state and provides a laundry list of "powers" available to regulators in the remaining states. These theoretical "powers" are grossly inadequate and largely unenforceable.

State Insurance Departments have limited financial resources and statutory authority. However, because of cooperation between states on financial examinations and other regulatory programs, the system does work well for the licensed insurance industry. S. 2129 creates a system of risk retention groups that will not be subject to the full powers of regulation and therefore creates a potentially dangerous regulatory situation. Without this regulatory power it is conceivable that risk retention groups will gravitate to less regulated jurisdictions, thereby jeopardizing the financial integrity of such organizations and their members.

While S. 2129 is well intentioned in attempting to solve availability and in some instances affordability problems for troubled enterprises, it creates a mechanism which could have serious consequences for consumers that currently do not have such problems. Just look at the problems created by ERISA. There is no reason why opportunistic entrepreneurs will not sing a siren song enticing "main street" businesses into Risk Retention Groups that are ill conceived, improperly funded and incompetently managed. By creating an unlevel playing field, S. 2129 extends an open invitation to abuse.

Previously, when groups ran into availability or affordability problems, or just thought they could do a better job themselves, their recourse was to form a mutual or stock insurance company or a reciprocal. This recourse is still available. It might be more difficult or more time consuming, but there is no doubt that it will be more financially secure under traditional state regulation.

In respect to the section creating Purchasing Groups, there appears to be absolutely no regulatory restraints on these groups. While some may feel that fictitious group laws and countersignature laws are archaic, their repeal should be at the state level and not in Federal legislation, which, while abolishing them, also abolishes any regulation at all.

We summarize our objections to S. 2129 as follows:

1. S. 2129 breaches the McCarran-Ferguson Act and seriously preempts state regulation.

2. S. 2129 would delay or prevent enactment of state tort reform legislation which would provide the most effective solution to the liability problem.

3. S. 2129 has no guidelines for either the formation or the operation of Risk Retention Groups.

4. S. 2129 grants limited jurisdiction to the one state in which it is chartered or licensed. The lack of adequate state regulation overlooks the greater need to protect the consumer public.

5. S. 2129 provides no conditions for solvency examinations until a group is possibly already in "financially impaired condition." The Act ignores the fact that successful solvency regulation is prospective in nature.

6. S. 2129 would tend to encourage organizations to pursue actuarially unsound self-insurance programs merely to gain apparent tax advantages and would place

rganizations with no insurance expertise, skills or disciplines in the business of in-
urance.

In conclusion, S. 2129 is ill conceived legislation with the potential of creating far
nore problems than solutions.

NATIONAL OUTFITTER AND LIVERY ALLIANCE,
Flagstaff, AZ, March 16, 1986.

Hon. BARRY M. GOLDWATER,
U.S. Senator, Senate Commerce, Science and Transportation Committee, Hart Senate Office Building, Washington, DC.

DEAR BARRY: The people who provide recreational activities and services for the public on the public lands are in deep trouble with the unaffordability and unavailability of liability insurance for the 1986 visitor use season, which is just about to begin.

The federal agencies (Park Service, Forest Service, BLM and Army Corps of Engineers) that issue the contracts and permits under which we operate have, so far, been completely unwilling to move from their positions that: unless we obtain and show them proof of liability insurance in the kinds, combinations, and amounts historically required, they will not let us open our doors for business this season.

The ramifications of this are staggering: There are about 1,500 resorts and summer camps nationwide; about 150 dude ranches; about 3,000 licensed animal packers, and about 1,100 river running companies. These are mostly small and medium-sized businesses that have been family-operated for several generations. They provide the personalized kind of service to the public that makes outings and vacations restful and meaningful.

If these visitor services are forbidden to operate by their federal managing agency (a) many of them, because of the extreme seasonality of their businesses, will be bankrupted, frustrating the federal mandate that private enterprise be the provider of facilities and services for the public on public lands; (b) the franchise and user fees that flow to the federal treasury from these concessioners and permittees will be seriously diminished and disrupted.

As you know, I am one of the 20 river trip concessioners in Grand Canyon National Park. These 20 concessioners annually talk about 15,000 park visitors down the river. The total gross revenue impact in our region is $14,000,000.00 and the franchise fees to the government are an estimated $100,000.00.

The National Park Service requires us to procure $2,000,000.00 in liability insurance for each of the 20 companies. We have asked for lower limits, and flexibility in how those limits are obtained, but our park superintendent has recommended against our request. Of the 20 companies, 9 have no insurance, and no source of any on the horizon; the remaining 11 begin their 1986 season on the "tail" of 1985 policies that expire at individual dates between April 1 and mid-July. No Grand Canyon river concessioner has possession of a liability insurance policy that carries through the 1986 visitor season.

The National Forest Recreation Association—of which I'm currently the president—has 5,000 members nationwide who are recreation residence owners, resort operators, marina operators, church and school camp operators, saddle trip outfitters, river trip operators, and hiking and climbing guides. In 1985 NFRA had an Association Master Policy, providing liability insurance coverage for about 2,000 recreational permittees nationwide. On September 30, 1985, that master policy was cancelled, and our Insurance Counsellor—a man who has been obtaining and writing recreational insurance for 28 years—has been unable to obtain replacement coverage, despite having contacted 200 insurance companies.

I recently learned of S. 2129, a risk-retention bill that has been referred to the Committee on Commerce, Science and Transportation.

That Bill, if enlarged, could save the outdoor recreation industry from the liability insurance crisis. To do so, it would need the following, which we respectfully urge you to incorporate:

1. That it specifically list the holders of recreational Contracts, Permits, and Commercial Use Licenses on public lands and waters among those allowed to form risk retention groups, so that the managing agencies will not "interpret us out" of eligibility.

2. That it specifically authorize the National Park Service, the US Forest Service, the Bureau of Land Management, and the US Army Corps of Engineers to waive their requirements for liability insurance during such periods that insurance may not be available at any price.

3. That it specifically authorize the above agencies to allow concessioners and permittees and licensees to operate on lower levels of coverage during such times as those lower levels may be available, but the higher, usually required limits, are not available.

4. That it specifically authorize the above agencies to lower the requirements when the higher required limits are unaffordable. (Explanation: The $2,000,000.00 requirement in Grand Canyon, for example is stipulated at $1,000,000.00 of underlying coverage plus a $1,000,000.00 "umbrella". Because an umbrella applies over all of a concessioner's operations, it is more expensive that just $1,000,000.00 worth of "excess coverage" on top of the liability exposure only. And—a high requirement like $2,000,000.00 virtually drives the coverage into the reinsurance market, which is where the capacity and cost problems exist.)

5. Provision for many recreational permittees needing the option of "going bare" if necessary, for the 1986 season. I do not have insurance for my Grand Canyon river trips, yet I have over 600 passengers booked, with reservations deposits paid in. As you may know, I ran Grand Canyon, in the days you were with me in the little wooden rowboats, without liability insurance of any kind—because I simply couldn't get it . . . anywhere. It was that way for my first 15 years or so. I want the option to do that again, if I can't get the insurance this summer. I know that many others do, too. It is a choice between the certainty of going out of business if the federal agencies forbid us to operate, or the very good chance of having another happy and successful season, operating very cautiously within the risks of which we're aware. Outfitters and guides are, by the nature of our business, risk-assessors and risk managers: we deal with it every foot of the way, every hour of a trip.

6. Allowing an outfitter's clients to sign a Waiver, whenever they are willing. In the past almost every outfitter had such a Form and almost every client was willing to sign it. The waivers blunted and averted lawsuits. In 1984 the Park Service forbade use of them and prescribed a bland "Acknowledgement" that is much less protective. We would like the Act to enable the use of individually drawn outfitter-client Waivers again.

We ask that these comments be submitted into the record of testimony on S. 2129 and will be glad to provide any further information that is needed.

Sincerely,

GAYLORD STAVELEY,
President.

AMERICAN BUS ASSOCIATION,
Washington, DC, March 18, 1986.

Hon. ROBERT W. KASTEN, JR.,
Chairman, Subcommittee on Consumer, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: On behalf of the American Bus Association and its 3,500 members, I appreciate the opportunity to testify and share with you this assessment of S. 2129 referred to as the "Risk Retention Act Amendments of 1986."

The membership of the American Bus Association has been devastated by horrendous increases in their insurance premiums. These increases threaten the existence of many companies and are the most serious issue facing us today and for the foreseeable future.

We believe that one solution to the problem confronting our members could be passage of the Risk Retention Act Amendments of 1986. With the ability to standardize regulations nationally and eliminate the costly, cumbersome process of compliance with fifty state agencies, our industry finds the first glimmer of light in addressing our needs in this insurance crisis.

We recognize that this legislation is not a cure-all. It can be, however, of substantial benefit to many organizations like our association which represents small business entities primarily.

Anything that the Congress can do to give associations a greater ability to organize its members to meet and deal with the current insurance crisis is welcome. It is important to explore and develop alternatives to the current market conditions so that industries are not dependent on individual insurance company decisions but may have a hand in controlling their own destinies, including both insurance availability and costs.

All over the countries, bus companies are being forced to the wall and many are going out of business due to insurance costs. The rates appear to have little relation to the loss experience of the companies.

In other cases, our members in the travel tourism industry are seeing their profits vanish, with no alternative but to go out of business or pass on costs to the public wherever possible. The result is not beneficial to these businesses nor to the public and the situation is almost totally out of hand. The outcry is coming from the grassroots all over America and it cannot be ignored.

We urge this committee and the Congress to act with all due haste to provide relief to our industry and other industries like ours.

Kindest Regards,

NORMAN R. SHERLOCK,
President and Chief Executive Officer.

THE AMERICAN COLLEGE OF OBSTETRICIANS AND GYNECOLOGISTS,
Washington, DC, March 20, 1986.

Hon. ROBERT W. KASTEN, Jr.,
Chairman, Subcommittee on Consumer, Hart Senate Office Building, Washington, DC.

DEAR SENATOR KASTEN: The American College of Obstetricians and Gynecologists (ACOG) believes the current crisis in the cost and lack of availability of professional liability insurance poses a major threat to the continued availability of quality obstetric care. This crisis affects not only board certified obstetrician-gynecologists, but all reproductive health care providers. In 1985 both the ACOG and the American College of Nurse-Midwives (ACNM) had their nationally sponsored liability cancelled. Neither group has been able to locate a new source of group coverage, but the situation facing the ACNM is more extreme. The ACNM has been forced to investigate the possibility of forming its own captive company or its members will be totally without a source for individual liability insurance.

The American College of Obstetricians and Gynecologists supports the practice of certified nurse-midwives in collaboration with obstetrician-gynecologists as spelled out in the "Joint Statement of Practice Relationships Between Obstetrician-Gynecologists and Certified Nurse-Midwives" dated November 1, 1982. In order for these practice relationships to be implemented, it is essential that both obstetrician-gynecologists and certified nurse-midwives have access to liability insurance at affordable rates.

The Risk Retention Act Amendments of 1986, S. 2129, is designed to remove legal and administrative obstacles to the establishment of self-insurance groups for general liability coverage. While ACOG has not studied and is therefore unable to take a position on this legislation, we support efforts to enable groups such as the ACNM to obtain liability insurance which is otherwise unavailable in today's market. The time is past when each of the fifty states could individually deal with the liability crisis. National leadership is needed now to address the tremendous liability problems facing the country.

Sincerely,

WILLIAM T. MIXSON, M.D., FACOG,
President.

NATIONAL LP-GAS ASSOCIATION,
Arlington, VA, March 31, 1986.

Hon. ROBERT W. KASTEN,
Chairman, Subcommittee on the Consumer, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

DEAR CHAIRMAN KASTEN: The National LP-Gas Association (NLPGA) is pleased that your Subcommittee is holding hearings on legislation to facilitate the ability of organizations to purchase liability insurance. As this is the most critical issue facing members of the propane gas industry today, we request that this statement and enclosures be accepted and made a part of the record of this hearing.

The members of the National LP-Gas Association (NLPGA) represent a cross-section of American business: from the largest producers of LP-gas (principally propane gas), a light hydrocarbon derived from crude oil refining and natural gas fractionation, to the smallest retailers, these 4000 member companies supply an essential fuel used by millions of homeowners for heating, cooking, and water heating. They all have been severely and seriously affected by the current crisis in insurance pricing and availability.

FEDERAL LAW ADDS TO PROBLEM

Although the extent of the impact of this crisis varies significantly according to each individual company's financial size and accident history, its effects have been exacerbated by legislation passed by Congress in 1980. Section 30 of the Motor Carrier Act of 1980 mandated that carriers of hazardous materials maintain certain minimum levels of financial responsibility. On January 1, 1985, following a five year phase in period, the full levels of financial responsibility took effect. As required by Section 30, carriers of propane gas and other hazardous materials in bulk, defined by the U.S. Department of Transportation as cargo tanks in excess of 3500 gallons water capacity, must maintain $5 million financial responsibility regardless of whether the cargo tank is operated in interstate or intrastate commerce. Cargo tanks of less than 3500 gallons capacity must be insured for $1 million if operated in interstate commerce. Section 30 also requires that the insurance cover not only personal injury and property damage but include coverage for "environmental restoration", a term left undefined in the statute.

Today, one year after implementation, the full effect of Section 30 is now being felt. Due to adverse court decisions, insurance companies are routinely excluding environmental restoration from such policies. Companies who a year ago were carrying as much as $20 million insurance are now finding it difficult, if not impossible, to even obtain $5 million. And the premiums are staggering.

SMALL BUSINESSES BEING FORCED OUT

In testimony before the Senate Small Business Committee, one small marketer from Oklahoma, Mr. Kenneth Green, noted that his insurance premiums went from $113,000 to $250,000, while his coverage dropped from $6 million to $5 million. Another company, Jubliee Gas Company, Inc. of Selma, Alabama, found it so difficult to obtain insurance that they decided to sell the business. Yet another business in Ohio had their excess insurance non-renewed last October despite a 30 year safety record that had won several awards from their insurer! They were able to obtain renewal only 8 hours before final cancellation. Their premiums increased from $13,000 to over $47,000. Indications are that it may exceed $100,000 next year. This company, a small, family business serving a few thousand homeowners dependent on propane for their heat, is now reviewing two bids to purchase the company instead of continuing the fight.

Enclosed are copies of some of the correspondence we have received from around the nation outlining the problems of propane gas dealers in this current crisis.

A RECOMMENDATION FOR IMMEDIATE RELIEF

Two immediate, alternative solutions would help propane gas dealers: (1) either repeal the $5 million statutorily-set financial responsibility requirements of Section 30 of the Motor Carrier Act of 1980; or, (2) amend Section 30 to delete the specified amount of insurance and vest in the Department of Transportation, Federal Highway Administration, authority to set appropriate levels of financial responsibility through rulemaking. We recommend either of these solutions because the safety record of this industry simply does not justify federally-established minimum levels of insurance, nor has any documented evidence ever been put forth to prove that $5 million ought to be the minimum level of insurance.

Until 1980, insurance levels for propane gas retailers and transporters were essentially the province of state regulatory authorities who handled the matter adequately. Section 30 was added in response to demands from the common carrier trucking industry for protection against new entries into the business who might not have the financial resources to maintain a viable enterprise. We support all efforts targeted at maintaining a high level of safety in over-the-road operations; however, we cannot agree that safety can be guaranteed by simply mandating certain minimum levels of financial responsibility.

The insurance industry testified in 1980 that they cannot be considered "policemen" who keep unsafe operators off the highways. The fact that a company has $5 million insurance merely indicates that they are able to afford the insurance and that there is sufficient underwriting capacity in the marketplace: it is not a guarantee of safe operations. In many states, assigned risk pools have been established by state law so that even if a company cannot obtain insurance through the regular market, they often can obtain it through assigned risk pools (although even this mechanism has broken down in this current crisis due to lack of capacity and the refusal of insurance companies to write policies covering "environmental restora-

tion"). Therefore, it is misleading and inaccurate to claim that minimum levels of financial responsibility ensure safety. It simply is not true.

At its most recent meeting on January 31, 1986, the National Motor Carrier Advisory Committee, a federal advisory committee established by the Administrator of the Federal Highway Administration and the Secretary of Transportation, adopted a resolution calling on Congress to re-examine the provisions of Section 30 of the Motor Carrier Act of 1980 particularly with respect to the appropriate levels of insurance. a copy of that Resolution and a list of Committee members are also enclosed.

Finally, we have enclosed a copy of a letter submitted to the Senate Commerce Committee on September 14, 1984, as part of that Committee's oversight of Section 30 of the Motor Carrier Act. In this letter, we reported the results of an accident and insurance survey we conducted of our members in February 1984. Two years ago—fully one year before the current insurance crunch hit American businesses—our survey revealed:

an enviable industry safety record which belied any alleged need for federally-mandated insurance;

anticipated cost increases that would be staggering, even in normal times, with no corresponding benefits; and,

a potential for actually reducing the level of operating safety by diverting scarce dollars from training, education and equipment maintenance and purchase in order to cover higher premiums.

The Federal Highway Administration's (FHwA) own statistics, as reported on page 5 of the enclosed letter to Senator Packwood, corroborate our survey findings. FHwA analyses revealed that only 6 of 32,393 accidents—two one-hundredths of one percent or a risk of 105 in a million—had aggregate societal costs in excess of $500,000. In short, there is no logical, rational justification of $5 million financial responsibility levels.

In conclusion, although we believe Section 30 to be unjustified and in need of repeal, we can support an amendment which would remove the $5 million mandate and, instead, vest in the FHwA authority to establish appropriate levels of financial responsibility through rulemaking because:

(1) it would permit a rational, deliberate rulemaking process, devoid of politics, emotion and hyperbole, which would allow for a thorough analysis of the costs and benefits of mandated insurance; and,

(2) in times of crisis such as we are now experiencing, the agency would have the flexibility to permit continued operation without the required—but temporarily unobtainable—insurance now mandated by law.

TORT REFORM

Another, more long term solution to the insurance crisis is through fundamental tort reform. Legislation has recently been introduced in the Senate in the form of S. 2046 by Senator Mitch McConnell (R-KY) entitled The Litigation Abuse Reform Act of 1986. The provisions of S. 2046 would apply to tort actions brought in federal court and would, among other things, require periodic payments over the estimated lifetime of an individual for damage awards in excess of $100,000; provide offsets for collateral source benefits; cap non-economic losses (e.g., pain and suffering) $100,000; limit attorney fees to a sliding scale of 35% of the first $50,000 awarded, 30% of the next $50,000, 20% of the next $100,000, and 10% of those amounts in excess of $200,000; prohibit attorney contingency fees based on punitive damages; limit the awards of punitive damages; to willful and wanton conduct, and mandate that such damages be paid to the U.S. Treasury, not to the plaintiff; and, penalize attorneys for bringing frivolous actions or suits merely with the intention of obtaining favorable settlements with no anticipation of success at law. NLPGA supports basic tort reform legislation such as S. 2046 both in the federal and state courts as essential in order to restore sanity to the U.S. civil justice system.

CONCLUSION

On behalf of the members of the propane gas industry and the National LP-Gas Association, we urge Congress to take immediate action to relieve the pressure on propane gas marketers who are unable to obtain statutorily mandated insurance at any price or at such a cost as to be economically unjustifiable. We are calling for immediate repeal of Section 30 of the Motor Carrier Act of 1980, or amendment to vest in the Department of Transportation, Federal Highway Administration, authority to establish appropriate levels of insurance.

We also call for immediate consideration of S. 2046 and similar tort reform legislation designed to restore a tort system that provides prompt, just and full compensation to injured victims at a reasonable cost without outraging common sense notions of justice.

Respectfully submitted,

DANIEL N. MYERS,
Vice President, Government Relations and General Counsel.

Enclosure.[1]

HOME WARRANTY CORP.,
Washington, DC, April 2, 1986.

Re: S. 2129.

Hon. ROBERT W. KASTEN, Jr.,
Chairman, Consumer Subcommittee of Senate Committee on Commerce, Science and Transportation, Hart Senate Office Bldg., Washington, DC.

DEAR SENATOR KASTEN: I am Secretary and General Counsel to Home Warranty Corporation, which is a membership corporation of 11,000 home builders nationwide and the parent company of HOW Insurance Company (WOWIC). As I know you are aware, WOWIC insurance part of the new home warranty liability risk of the builder members and has been operating since 1981 as a risk retention group under the Product Liability Risk Retention Act. In fact, HOWIC, is the only group to have its risk retention status judicially confirmed. *See Home Warranty Corp.* v. *Elliott,* 572 F.Supp. 1049 (D.Del. 1983), 585 F.Supp. 443 (D.Del. 1984). Over the years, the Act has proved very beneficial to HWC's builder members and has enabled them to self insure part of their product liability risk as well as provide a useful protection to consumers.

We have become aware that Congress is considering amending the Act to extend its coverage to liability as well as product liability risk. HWC applauds that effort yet, understandably, wishes to make sure that the amendment proposed, S 2129, will not restrict HOWIC's authority to continue operation under the Act. One concern HWC has is the definition in S 2129, Sec. 3(a)(3) of the term "personal risk insurance." As currently drafted, personal risk insurance includes "homeowners' insurance" and "other liability and casualty insurance primarily for . . . family or household needs." While home warranty insurance is not included within that definition, nonetheless, HWC is fearful that some state insurance commissioner or judge may misinterpret the language of the amendment to preclude the formation of risk retention groups that spread members' risks arising out of the manufacture of new homes. Accordingly, we request that the legislative history make clear, as was done in 1981, that programs like ours are authorized just as they were under the Product Liability Risk Retention Act.

Our concern over judicial misinterpretation of the Act is not without precedent. HWC and HOWIC are currently litigating a case before the United States Court of Appeals for the Eleventh Circuit, which demonstrates the point. HWC and HOWIC, when threatened by a cease and desist order of the Georgia Insurance Commissioner, sued in federal district court to get an injunction against the Commissioner and a declaratory judgment that HOWIC was a risk retention group. Indeed, the U.S. District Court for the Northern District of Georgia ruled in HOWIC's favor and declared it a risk retention group under the Act. *See Home Warranty Corp.* v. *Caldwell,* No. 83-812A (N.D.Ga. 1984).

A three judge panel of the Eleventh Circuit, however, vacated the decision primarily on the ground that the District Court did not have a sufficient factual record upon which to make its ruling. In rendering that decision, however, the panel made several statements which, we contend, clearly misconstrue the Act and congressional intent. For example, after having concluded that the risk against which HWC members are insured (that is risk as contemplated by the Act, nonetheless, the Court stated that before risk retention status could be conferred, an inquiry had to be made to determine whether the protection affored is merely an "alternate source of recovery" for the injured party. Moreover, the Court also required an inquiry into the source of the right of recovery of the injured party, specifically whether the right of recovery arises out of tort law or contract law.

We submit that inquiries into alternate sources of recovery and the sources of the right to recovery are examples of how courts can misconstrue congressional intent.

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[1] The enclosures are in the Committee files.

t has always been the understanding of HWC that as long as the risk involved (in his case the builder's risk of damage to homes due to major structural defects) was roduct liability risk as that term is construed by any of the 50 states, it did not natter whether there were other sources of recovery available to the injured party r whether the right to recovery in a specific case stems from contract law or tort aw.

The full court of the Eleventh Circuit currently is deciding whether to set the anel decision aside. Accordingly, we urge you and the subcommittee to take this imely opportunity to further supplement the congressional record to make clear to ourts which will interpret the Product Liability Risk Retention Act and its amendments, that Congress' intent is to facilitate the formation of risk retention groups vithout unwarranted interference by courts which, for whatever reason, may attempt to erect obstacles (such as the alternate source of recovery requirement) not ontemplated by nor prescribed by Congress.

Thank you for your consideration and attention to this matter. We respectfully equest that this letter be made part of the March 20, 1986 public hearing record on 2129. HWC stands ready to work with you and your staff for the passage of S 129.

Sincerely,

HAMILTON H. BOYKIN,
Secretary.

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